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No. (1)

Supreme Court, U.S.
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In The

Supreme Court of the United States

MARRITA MURPHY,

Petitioner,

v.

INTERNAL REVENUE SERVICE
and UNITED STATES OF AMERICA,

Respondents.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The District Of Columbia Circuit

PETITION FOR A WRIT OF CERTIORARI

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QUESTIONS PRESENTED

(1) Can Congress tax "make whole" personal injury or sickness damage awards that are solely intended as compensation for a loss (or restoration of human capital), as opposed to income or any accession to wealth, in accordance with this Court's holdings in *Comm'r. v. Glenshaw Glass Co.*, 348 U.S. 426 (1955) and *O'Gilvie v. United States*, 519 U.S. 79 (1996)?

(2) Is the tax on Ms. Murphy's compensatory damages permitted by the Sixteenth Amendment to the Constitution, by 26 U.S.C. § 61(a), or by any other section of the tax code?

(3) Should compensatory damages awarded to Ms. Murphy based on evidence, including, among other physical injuries, permanent damage to her teeth and physical manifestations of stress resulting from the violation of her legally cognizable federal statutory rights, be excluded from gross income based on Internal Revenue Code ("IRC"), 26 U.S.C. § 104(a)(2)?

PARTIES TO THE PROCEEDINGS

The following is a list of all parties who have appeared before the D.C. Circuit:

Petitioner

Marrita Murphy and Daniel J. Leveille, Plaintiff-Appellants.

Respondents

Internal Revenue Service and United States of America, Defendants-Appellees.

Amici Curiae

The following amici curiae parties were admitted: No Fear Coalition, The National Employment Lawyers Association, Andrew Jackson Society, National Taxpayers Union, Liberty Coalition, and Innocence Project.

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PETITION FOR A WRIT OF CERTIORARI

Petitioner respectfully petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the District of Columbia Circuit in this case.

OPINIONS BELOW

The opinion of the Court of Appeals for the D.C. Circuit on panel rehearing is reported at 493 F.3d 170 (hereinafter, "*Murphy II*") and is reprinted in the appendix hereto at App. 1-38, *infra*.

The initial opinion of the Court of Appeals for the D.C. Circuit that was vacated on rehearing is reported at 460 F.3d 49 (hereinafter, "*Murphy I*") and is reprinted in the appendix hereto at App. 39-67, *infra*.

The order of the Court of Appeals for the D.C. Circuit granting panel rehearing has not been reported and it is reprinted in the appendix hereto at App. 68-69, *infra*.

The order of the Court of Appeals for the D.C. Circuit denying the respondents' petition for rehearing en banc as moot has not been reported and it is reprinted in the appendix hereto at App. 70-71, *infra*.

The memorandum decision and order of the United States District Court for the District of Columbia (Lamberth, D.J.) is reported at 362 F.Supp.2d

206 and is reprinted in the appendix hereto at App. 72-94, *infra*.

The order of the Court of Appeals for the D.C. Circuit denying the petitioner's petition for rehearing en banc has not been reported and it is reprinted in the appendix hereto at App. 95-96, *infra*.

JURISDICTION

The Court of Appeals entered its opinion on July 3, 2007, and petition for rehearing en banc was timely sought. On September 14, 2007, the Court of Appeals for the D.C. Circuit denied the petition for rehearing en banc. The jurisdiction of this Court to review the judgment of the D.C. Circuit is invoked under 28 U.S.C. § 1254(1).

CONSTITUTIONAL, STATUTORY AND REGULATORY PROVISIONS INVOLVED

A. U.S. Constitution.

Amendment XVI: Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several states, and without regard to any census or enumeration.

U.S. Const. art. 1, § 2, cl. 3: Representatives and direct Taxes shall be apportioned among the several States which may be included within this Union,

according to their respective Numbers, which shall be determined by adding to the whole Number of free Persons, including those bound to Service for a Term of Years, and excluding Indians not taxed, three fifths of all other Persons.[1]

U.S. Const. art. 1, § 8, cl. 1: The Congress shall have Power To lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and Welfare of the United States; but all Duties, Imposts and Excises shall be uniform throughout the United States.

U.S. Const. art. 1, § 9, cl. 4: No Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken.

B. Statutes.

Section 61(a) of the tax code, entitled, "Gross Income Defined," is applicable:

> (a) General definition
>
> Except as otherwise provided in this subtitle, *gross income means all income from whatever source derived*, including (but not limited to) the following items:

---

[1] Changed by section 2 of the Fourteenth Amendment.

(1) Compensation for services, including fees, commissions, fringe benefits, and similar items;

(2) Gross income derived from business;

(3) Gains derived from dealings in property;

(4) Interest;

(5) Rents;

(6) Royalties;

(7) Dividends;

(8) Alimony and separate maintenance payments;

(9) Annuities;

(10) Income from life insurance and endowment contracts;

(11) Pensions;

(12) Income from discharge of indebtedness;

(13) Distributive share of partnership gross income;

(14) Income in respect of a decedent; and

(15) Income from an interest in an estate or trust.

(b) Cross references

For items specifically included in gross income, see part II (sec. 71 and following). For

> items specifically excluded from gross income, see part III (sec. 101 and following).

See 26 U.S.C. § 61 (emphasis added).

The following parts of Section 104(a) of the tax code, entitled, "Compensation for injuries or sickness," are applicable:

> . . . gross income does not include – . . . (2) the amount of any damages (other than punitive damages) received (whether by suit or agreement and whether as lump sums or as periodic payments) on account of personal physical injuries or physical sickness.
>
> * * *
>
> For purposes of paragraph (2), emotional distress shall not be treated as a physical injury or physical sickness.

26 U.S.C. § 104(a), as amended in 1996.

C. Regulations.

The following parts of Treasury Regulation, § 1.104-1, are applicable:

> (c) Damages received on account of personal injuries or sickness. *Section 104(a)(2) excludes from gross income the amount of any damages received* (whether by suit or agreement) *on account of personal injuries or sickness*. The term "damages received (whether by suit or agreement)" means an amount received (other than workmen's compensation)

> through prosecution of a legal suit or action based upon tort or tort type rights, or through a settlement agreement entered into in lieu of such prosecution.

26 C.F.R. § 1.104-1(c) (2005) (emphasis added).

STATEMENT OF THE CASE

The two decisions of the D.C. Circuit in this case struggle with an issue that has been avoided since the modern tax code was enacted in 1918, namely, whether damages received on account of personal injury and solely to restore a personal injury loss are taxable as income. This important federal question needs to be resolved now because the 1996 amendments to the statutory exemption for taxing personal injury damages have created doubt and widespread uncertainty as to the tax treatment of personal injury damages.

In this case, Petitioner Marrita Murphy successfully obtained an award of compensatory damages in the amount of $70,000 to compensate her solely for personal injuries in the form of damage to her reputation, emotional distress and physical problems resulting from the mental distress. App. 3-4; App. 71-75. As the case comes to this Court, it is undisputed that none of the compensatory damages awarded to Ms. Murphy were for lost wages, back pay or front pay. Additionally, none of these damages awarded to Ms. Murphy represented punitive damages, liquidated damages or

attorneys fees. It is also undisputed that the sole purpose of the compensatory damages award at issue in this tax refund case was to make Ms. Murphy "whole" for suffering personal injuries resulting from illegal retaliation committed by her former employer, the New York Air National Guard ("NYANG"). App. 3-4; App. 73-75.

Petitioner commenced an action in the district court seeking a tax refund from the United States for the wrongful assessment of a tax on the "make whole" compensatory damages awarded to her for injuries and sickness that she sustained as a result of illegal retaliation by her former employer. App. 4-5; App. 75. The basis for federal jurisdiction in the district court is 28 U.S.C. § 1346, which provides for jurisdiction over Petitioner's tax refund claim. App. 76.

As part of the summary judgment record, Ms. Murphy submitted the affidavits of two doctors who testified that the injuries for which she was awarded compensatory damages included bruxism, permanent damage to her teeth, and other physical injuries. App. 74. These affidavits and summary judgment record showing that Ms. Murphy's "bruxism" and permanent damage to her teeth is the result of NYANG's illegal acts was not disputed by Respondents. *Id.* The district court granted Respondents' motion for summary judgment despite finding that Ms. Murphy sustained permanent physical injuries in the form of bruxism and permanent teeth damage, and that she "suffered from other 'physical manifestations of stress.'" The district court concluded that Ms. Murphy's damages

fell outside the scope of the personal injury exemption because they were "attributable to" emotional distress and not physical injury. App. 84-85. Additionally, the district court erred by concluding that Ms. Murphy's damages were gross income pursuant to 26 U.S.C. § 61(a) and under the Sixteenth Amendment. *Id.*

This tax refund case is now in a unique posture. For the first time the issue of whether compensatory damages for non-physical injuries is squarely before this Court. This is a major issue impacting not only the employment bar, but all cases in which any person obtains any compensatory damages for a mental illness.

After full briefing and oral argument, the D.C. Circuit initially reversed the district court and held that the tax on Murphy's award of non-physical "make whole" compensatory damages to vindicate her rights under six federal environmental whistleblower statutes did not fall within the co-extensive meaning of income set forth in the Sixteenth Amendment to the U.S. Constitution and 26 U.S.C. § 61(a). App. 39-67. In *Murphy I*, the D.C. Circuit correctly held that the personal injury damages received by Ms. Murphy were not taxable as gross income. In reaching this decision the D.C. Circuit correctly applied the reasoning in a long line of Supreme Court cases and departmental rulings, and held that Ms. Murphy's personal injury damages were analogous to a "restoration of capital" and "received 'in lieu of' something 'normally untaxed,'" and, therefore, "is not income under the Sixteenth Amendment," and "is neither a

'gain' nor an 'accession[] to wealth.'" App. 58, citing *O'Gilvie v. United States*, 519 U.S. 79, 86 (1996); *Commissioner v. Glenshaw Glass*, 348 U.S. 426, 430-31 (1955).

Respondents filed a petition for rehearing *en banc*, arguing for the first time that the tax at issue was constitutional under Article I of the Constitution.[2] After panel rehearing, the D.C. Circuit issued *Murphy II*, deciding *sua sponte* matters that were not raised by the parties and considering the issue belatedly raised for the first time by Respondents in their petition for rehearing. App. 1-38.

Notably, the D.C. Circuit in *Murphy II* does not overrule or disagree with the essential holding of *Murphy I*, that Murphy's damages are not "income." Instead, the D.C. Circuit went through a number of contortions and considered several issues not raised by the parties to avoid the very issue that needs to be addressed, whether "make whole" damages for personal

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[2] On appeal, initially, Respondents deliberately chose not to argue that the tax at issue was an indirect excise tax under Article I, and as such it was waived. *U.S. ex rel. Totten v. Bombadier Corp.*, 380 F.3d 488, 497 (D.C. Cir. 2004); *Ark Las Vegas Rest. Corp. v. NLRB*, 334 F.3d 99, 108 n. 4 (D.C. Cir. 2003); *Whately v. District of Columbia*, 447 F.3d 814, 821 (D.C. Cir. 2006); *District of Columbia v. Air Florida, Inc.*, 750 F.2d 1077, 1084 (D.C. Cir. 1984). Additionally, in the district court, Respondents argued that Murphy's damages "*constitute 'income' under the Sixteenth Amendment.*" *Murphy v. IRS*, No. 03-cv-02414, Doc. No. 21, Def. Opp. To Pltf. Mtn. for Partial Summary Judgment, p. 5 (Oct. 25, 2004) (emphasis added), citing *Glenshaw Glass*, 348 U.S. at 431-432 & n. 11.

injury awarded solely to restore a personal injury loss is taxable as income. The D.C. Circuit's holding that Murphy's damages are taxable conflicts with the legal standards adopted by this Court and in other circuits, and departs from the text of the amended statute at issue. Ms. Murphy prevailed under the legal standards applied in other circuits and this Court, and review should be granted to resolve this important federal question and the conflicts between the D.C. Circuit's decision and the relevant decisions of this Court and of other circuits.

This Court should grant review to resolve whether an income tax on personal injury damages received to make the victim "whole" for loss of reputation or emotional and physical injuries violates the Sixteenth Amendment or is within the scope of 26 U.S.C. § 61(a), the gross income statute. This Court should also grant review to resolve important questions about the interpretation of the 1996 amendments to Section 104(a)(2) under the Supreme Court's *Schleier* test.

REASONS FOR GRANTING THE WRIT

I. WHETHER PERSONAL INJURY DAMAGES AWARDED SOLELY TO COMPENSATE FOR A LOSS (OR RESTORE HUMAN CAPITAL) ARE TAXABLE AS GROSS INCOME IS AN IMPORTANT QUESTION OF FEDERAL LAW THAT IS EITHER NOT SETTLED BUT SHOULD BE RESOLVED BY THIS COURT, OR HAS BEEN DECIDED BY THE D.C. CIRCUIT IN A WAY THAT CONFLICTS WITH RELEVANT DECISIONS OF THIS COURT AND OTHER CIRCUITS.

A. Whether Damages Awarded Solely to Compensate for Personal Injury Losses (and Not for Wages or Liquidated or Punitive Damages), Are Taxable Income Needs to be Resolved.

The questions presented here follow a series of cases deciding the tax treatment of damages under the personal injury exemption, 26 U.S.C. § 104(a)(2). In recent years, this Court has granted review to determine whether certain damages received by plaintiffs fell within the scope of the statutory exemption from gross income for personal injury damages. *United States v. Burke,* 504 U.S. 229 (1992) (whether back pay damages awarded under Title VII of the Civil Rights Act of 1964, which at the time did not provide for an award of compensatory damages, were exempt under Section 104); *Commissioner of Internal Revenue v. Schleier*, 515 U.S. 323 (1995) (whether

liquidated damages awarded under the Age Discrimination in Employment Act were exempt); *O'Gilvie v. United States*, 519 U.S. 79 (1996) (whether punitive damages fell within the scope of the personal injury exemption); *Commissioner v. Banks*, 543 U.S. 426 (2005) (whether the portion of a damages recovery paid to a litigant's attorney under a contingent fee agreement is taxable).

As this Court recognized in *O'Gilvie*, the question of whether compensatory damage awards can be taxed as income dates back to 1918 when the modern tax code was enacted. In *O'Gilvie*, this Court reviewed this history and noted that the courts have held a number of times after the Sixteenth Amendment was enacted that "a restoration of capital was not income; hence it fell outside the definition of 'income' . . . " *O'Gilvie*, 519 U.S. at 84. The *O'Gilvie* court went on to recount the analysis of the Treasury Department, Attorney General and the courts following the enactment of the Sixteenth Amendment and the modern income tax code, concerning whether compensatory damages for personal injury are taxable as income under the "return of human capital" analogy. *O'Gilvie*, 519 U.S. at 84-87. The "return of human capital" analogy was expressly adopted by the IRS in 1918, in 1922, and in 1974, and was acknowledged by the Supreme Court in *Glenshaw Glass* and *O'Gilvie*. *See Glenshaw Glass*, 348 U.S. at 433 n. 8; *O'Gilvie*, 519 U.S. at 84-87; 31 Op. Att'y Gen. 304 (1918); T.D. 2747, 20 Treas. Dec. 457 (1918); Sol. Op. 132, 1-1 C.B. 92, 03 (1922). *Also see* Rev. Rul. 74-77, 1974-1 C.B. 33,

1974 WL 34538 (IRS RRU) (adopting Sol. Op. 132 and agreeing that such non-physical personal injury damages "are not income").

However, because *O'Gilvie* concerned the taxing of punitive damages, this Court has not had the occasion to consider directly whether "make whole" compensatory damages for personal injury are income.

What was discussed in dictum in *Glenshaw Glass* and *O'Gilvie*, regarding the "return of human capital" analogy and whether compensatory damages to restore "human capital" is taxable as income is squarely presented in this case. The record of this case does not concern punitive damages, wages, liquidated damages or attorneys fees. Rather, this Court should now grant review to decide whether compensatory damages for loss of reputation, emotional distress and physical problems resulting from illegal conduct are income within the meaning of the gross income statute, 26 U.S.C. § 61(a), and the Sixteenth Amendment. In addition, review should be granted to determine the scope of the personal injury exemption when a plaintiff suffers personal injuries that include physical injury or physical problems and also suffers emotional distress.

For more than a decade, since the personal injury exemption was amended in 1996, taxpayers, employers and employees, have struggled with the taxability of compensatory damages for emotional distress, physical injuries related to emotional distress, and

loss of reputation. Even though Section 104(a)(2) was amended in 1996, Congress did not include or further define the scope of gross income under the tax levying statute, 26 U.S.C. § 61(a), and the IRS regulations implementing Section 104, 26 C.F.R. § 1.104-1(c) (2005), do not require physical injury or physical sickness to qualify for the personal injury exemption, thus causing widespread confusion, uncertainty and litigation.

When the D.C. Circuit was confronted with the questions presented here, the Court of Appeals issued two decisions that conflict with each other, causing further confusion and uncertainty, and generating considerable public debate and commentary. *See* Pet. Section II, pp. 33-35, *infra*. Although a second opinion was issued by the D.C. Circuit, the Court of Appeals never directly repudiated or overruled its prior decision holding that Murphy's compensatory damages are not income. Instead, in *Murphy II* the D.C. Circuit went to great pains to sidestep the entire issue of whether the kind of compensatory damages for personal injury at issue are income, and simply arrived at a different result based on issues not raised by the Respondents and designed to avoid the very issue that this Court identified but did not directly decide in *Glenshaw Glass* and *O'Gilvie*: whether compensatory damages for personal injury are income. Despite the machinations in the Court of Appeals, the issues raised in this case are straightforward and strike at the very core of whether compensatory damages to restore "human capital" is taxable as income. Further

percolation promises only to increase confusion and uncertainty.

B. The D.C. Circuit Failed to Follow *Glenshaw Glass.*

The D.C. Circuit's decision conflicts with controlling Supreme Court case law requiring that a tax on gross income under Section 61(a) satisfy the "accession to wealth" test. *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 430 (1955). Despite that both the Government and Murphy agreed that *Glenshaw Glass* was the controlling test, and after ruling in *Murphy I* that Murphy's damages were not an "accession to wealth" and therefore not "income," the D.C. Circuit made a fundamental error in *Murphy II* by concluding, "it is unnecessary to determine if there was an accession to wealth" in order to tax her damages under Section 61(a). App. 19-20.

Ms. Murphy's "make whole" personal injury damages are not taxable as "income" under either Section 61(a), or the Sixteenth Amendment. In a long line of cases, the Supreme Court and circuit courts have drawn a sharp distinction between monetary awards which constitute an "accession to wealth" and awards that make a person "whole" for restoring a personal loss. *See, e.g., Doyle v. Mitchell Bros.*, 235 F. 686, 688 (6th Cir. 1916) (monies paid to compensate for losses in a fire are not income); *Southern Pacific Co. v. Lowe*, 247 U.S. 330, 335 (1918) (return of capital not income under the tax code or Sixteenth

Amendment); *Burk-Waggoner Oil v. Hopkins*, 269 U.S. 110, 114 (1925) (Brandeis, J.) (neither Congress nor the Courts are permitted to "make a thing income which is not so in fact"); *Commissioner v. Glenshaw Glass Co.*, 348 U.S. 426, 432, n. 8 (1955) (personal injury recoveries are "by definition compensatory only" and nontaxable as contrasted with punitive damages); *U.S. v. Kaiser*, 363 U.S. 299, 311 (1960) (Frankfurter, J., concurring) (Strike benefits not income and stating, "The principle at work here is that payment which compensates for a loss of something which would not itself have been an item of gross income is not a taxable payment"); *O'Gilvie v. United States*, 519 U.S. 79, 84-86 (1996) ("a restoration of capital [is] not income; hence it [falls] outside the definition of 'income' upon which the law impose[s] a tax"); *Hawkins v. Commissioner*, 6 B.T.A. 1023, 1024-1025 (U.S. Bd. Tax. App. 1927) ("compensation for injury to [plaintiff's] personal reputation" was not income because it was "an attempt to make the plaintiff whole as before the injury."); *Dotson v. U.S.*, 87 F.3d 682, 685 (5th Cir. 1996) (personal injuries for physical or emotional well-being nontaxable as a "return of human capital").

Applying the consistent and unbroken line of cases interpreting the meaning of "income," the history surrounding the passage of the Sixteenth Amendment and the tax code, and the commonly understood meaning of "income" under the tax codes enacted under the Sixteenth Amendment, requires a finding that Murphy's compensatory damages award

for an actual loss of reputation and to restore her emotional or physical well being is not income.

Congress based its definition of income in Section 61(a), as "all income from whatever source derived," directly upon the Sixteenth Amendment. *Glenshaw Glass Co.*, 348 U.S. at 431-432 and n. 11, citing H.Rep. No. 1337, 83d Cong., 2d Sess. A 18; S.Rep. No. 1622, 83d Cong., 2d Sess. 168 (The word "income" in 26 U.S.C. § 61(a) is based on the Sixteenth Amendment and "is used in its constitutional sense.").

The Supreme Court has defined the meaning of the term "income" as it is used in the Sixteenth Amendment and the tax codes enacted thereunder. *Doyle*, 235 F. at 688 (monies paid to compensate for losses in a fire are not income).[3] The *Doyle* precedent has not been questioned, and this Court has previously stated that *Doyle* and other cases set forth what was "believed to be the commonly understood meaning of

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[3] Shortly after *Doyle*, the Supreme Court defined "income" as a "gain derived from capital, from labor, or from both combined." *Eisner v. Macomber*, 252 U.S. 189, 207 (1920). Justice Brandeis dissented out of concern that the definition of income did not include various means for which persons could obtain income which were not directly related to a gain from capital or labor. *Eisner*, 252 U.S. at 226 (Brandeis, J., dissenting). However, Justice Brandeis did not dispute the *Doyle* holding or that compensating a person for a loss was not income. Justice Brandeis' opinion in *Burk-Waggoner Oil*, that the term "income" limited Congress' taxing authority as Congress "cannot make a thing income which is not so in fact," is also notable because he firmly acknowledged the limiting authority of the term "income" as set forth in the Sixteenth Amendment.

the term [income] which must have been in the minds of the people when they adopted the Sixteenth Amendment . . . '" *Merchants' L. & T. Co. v. Smietanka*, 255 U.S. 519 (1921), citing *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 185 (1918). Undoubtedly, "the term 'income' as commonly understood" at the time of adoption of the Sixteenth Amendment would not include Murphy's "make whole" compensatory damages. *Id.*

The D.C. Circuit's holding is also at odds with a long line of cases and Departmental rulings issued both before and after *Glenshaw Glass*. In 1922, the Treasury Department stated that money received for alienation for affection or for lost reputation "*does not constitute income within the meaning of the sixteenth amendment and the statutes enacted thereunder.*" Sol. Op. 132, 1-1 C.B. 92, 03 (1922) (emphasis added); Rev. Rul. 74-77, 1974-1 C.B. 33, 1974 WL 34538 (IRS RRU) (restating Sol. Op. 132 and finding amounts received for alienation of affections "*are not income.*") (emphasis added). That ruling was based on Supreme Court decisions interpreting the definition of income under the Sixteenth Amendment and remained in full force after *Glenshaw Glass* was decided. Sol. Op. 132, *supra.*, citing *Stratton's Independence v. Howbert*, 231 U.S. 399; *Eisner*, 252 U.S. at 207. *Also see*, *Doyle*, *supra.*; *Hawkins*, *supra.*; *Starrels v. Commissioner*, 304 F.2d 574, 576 (9th Cir. 1962) (damages "for personal injuries . . . make the taxpayer whole from a previous loss of personal rights – because, in effect, they restore a loss to capital.").

The questions presented were settled by the Treasury Department in 1922 when it held that "make whole" non-physical personal injury damages are not income within the meaning of the Sixteenth Amendment or any of the tax laws enacted thereunder. Sol. Op. 132, *supra*. ("the question is really more fundamental, namely, whether such damages are within the legal definition of income.").[4]

Notably, the D.C. Circuit's decision in this case ignores decisions of this Court and the Fifth Circuit noting that damages for personal injuries are non-taxable as a "return of human capital." *Dotson v. U.S.*, 87 F.3d 682, 685 (5th Cir. 1996) ("Congress first enacted the personal injury compensation exemption in 1918 at a time when such payments were considered the return of human capital, and thus not constitutionally taxable "income" under the Sixteenth Amendment. H.R. Rep. No. 767, 65th Cong., 2d Sess. 9-10 (1918)."); *Glenshaw Glass*, 348 U.S. at 433 n. 8; *O'Gilvie*, 519 U.S. at 84-86.

"Accessions," as commonly understood, requires an addition to wealth or property. *See* Webster's New International Dictionary, Second Edition (unabridged), p. 14 (1935); Black's Law Dictionary (8th Edition, 2004) ("A property owner's right to all that is

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[4] The D.C. Circuit's failure to accord deference to Sol. Op. 132 and Rev. Rul. 74-77 also conflicts with Supreme Court precedent. *Davis v. United States*, 495 U.S. 472, 484 (1990); *Christensen v. Harris County*, 529 U.S. 576, 587 (2000); *Skidmore v. Swift & Co.*, 323 U.S. 134, 140 (1944).

added to the property, naturally or by labor. . . .") (emphasis added). It is not an all-encompassing term which would include monetary payments for restoration of a loss – be that a loss to a house or a hand. Indeed, the Supreme Court did not disturb the "long history of departmental rulings holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital. . . ." *Glenshaw Glass*, 348 U.S. at 433 n. 8.

It has long been held that not everything that is paid to an individual is income. Simply because Murphy received $70,000 as her "make whole" award does not mean that she realized an accession to wealth. Sol. Op. 132, *supra*. ("the Supreme court has repeatedly held that gross income does not include everything that comes in."), citing *Lynch v. Turrish*, 247 U.S. 211 (1918); *Eisner, supra.*; *Stratton's Independence*, *supra*. *Also see*, *Bowers v. Kerbaugh-Empire*, 271 U.S. 170 (1926). Murphy's losses were valued in her whistleblower case by the U.S. Department of Labor, which determined Murphy's wealth was diminished as a result of her personal injuries by $70,000. A straightforward application of *Glenshaw Glass* shows that Murphy's "accession to wealth" was zero.

Murphy's "make whole" damages for personal injury are not income under *Glenshaw Glass*, because they are not an "accession to wealth" in light of the "long history" of authorities. *See Dotson*, 87 F.3d at 685; *Glenshaw Glass*, 348 U.S. at 433 n. 8; *O'Gilvie,* 519 U.S. at 84-87; 31 Op. Att'y Gen. 304 (1918); T.D.

2747, 20 Treas. Dec. 457 (1918); Sol. Op. 132, *supra.*; Rev. Rul. 74-77, *supra. Also see, Hawkins*, 6 B.T.A. at 1025 ("Such compensation as general damages adds nothing to the individual, for the very concept which sanctions it prohibits that it shall include a profit. It is an attempt to make the plaintiff whole as before the injury.").

Initially determining that Murphy's damages are not income, the D.C. Circuit correctly followed the Supreme Court in asking whether damages are "a substitute for [a] normally untaxed personal . . . quality, good, or 'asset.'" App. 58, quoting *O'Gilvie*, 519 U.S. at 86. Additionally, the D.C. Circuit in *Murphy I* joined the other circuits by asking: "In lieu of what were the damages awarded?" App. 58, citing *Raytheon Prod. Corp. v. Commissioner*, 144 F.2d 110, 113 (1st Cir. 1944); *Francisco v. United States*, 267 F.3d 303, 319 (3rd Cir. 2001); *Tribune Publishing Co. v. United States*, 836 F.2d 1176, 1178 (9th Cir. 1988); *Gilbertz v. United States*, 808 F.2d 1374, 1378 (10th Cir. 1987). The D.C. Circuit correctly applied these tests to reach the conclusion that Murphy's award was received "in lieu of" something "normally untaxed," and as such was not income under either the Sixteenth Amendment or the gross income statute because compensatory damages awards for personal injury losses are not a "gain" or "accession[] to wealth." App. 58-59, quoting, *O'Gilvie*, 519 U.S. at 86 and *Glenshaw Glass*, 348 U.S. at 430-31.

Having recognized the obvious, the D.C. Circuit was thus obliged to apply the "in lieu of what?" test

and determine whether Murphy's damages were in fact income. In *Murphy II*, however, the D.C. Circuit did not address these necessary questions at all. This glaring omission by the D.C. Circuit in *Murphy II* conflicts with the Supreme Court's decisions in *Glenshaw Glass* and *O'Gilvie*, which require the courts to determine whether the damages at issue are income in the first instance. Since Section 61(a) only taxes gross income, and that is the only tax-levying statute at issue in this case, there was no basis for the D.C. Circuit to depart from the Supreme Court's well-established method of applying the income test under *Glenshaw Glass* and *O'Gilvie,* as well as the under the "in lieu of what?" test.

C. Implying A Tax Conflicts With Supreme Court and Circuit Precedent.

Murphy's damages simply do not fall within the definition of income used in the catchall phrase of Section 61(a), or within the meaning of income in the Sixteenth Amendment upon which Section 61(a) is based. *See Gould v. Gould*, 245 U.S. 151, 153 (1917). In *Gould*, the Supreme Court held that alimony could not be taxed under the Revenue Act of 1913 because it did not fall within the statutory definition of income, including the catchall provision of the predecessor to Section 61(a), the gross income statute. *Cf.* Revenue Act of 1913, § II(B), 38 Stat. 167 (defining gross income as "income derived from any source whatever."); 26 U.S.C. § 61(a).

In reaching the Article I issue, the D.C. Circuit violated the holding in a number of Supreme Court cases, and cases of other circuits, that a tax levying statute may not be extended by implication, and where there is doubt as to the validity of the tax, all doubt must be construed most strongly in favor of the taxpayer and against the Government. *See Gould*, 245 U.S. at 153; *Smientanka v. First Trust & Savings Bank*, 257 U.S. 602 (1921); *Reinecke v. Gardner*, 277 U.S. 239, 244 (1928); *McFeely v. Commissioner of Internal Revenue*, 296 U.S. 102, 111 (1935); *White v. Aronson*, 302 U.S. 16 (1937); *Gellman v. United States*, 235 F.2d 87, 93 (8th Cir. 1956); *Ellis v. U.S.*, 416 F.2d 894 (6th Cir. 1969); *Princess Cruises, Inc. v. United States*, 397 F.3d 1358, 1362 (Fed. Cir. 2005); *Ocean Drilling & Exploration Co. v. United States*, 988 F.2d 1135, 1156 (Fed. Cir. 1993); *America Online, Inc. v. United States*, 64 Fed. Cl. 571, 576 (Ct.Cl. 2005). *Accord.*, *United Dominion Indus., Inc. v. United States*, 532 U.S. 822, 839 (2001) (Thomas, J., concurring); *id.*, 532 U.S. at 839 n. 1 (Stevens, J., dissenting). There is no valid justification to depart from this cardinal rule of construction of tax levying statutes.

Additionally, the D.C. Circuit held *sua sponte* there was an amendment by implication to Section 61(a), but that holding conflicts with precedent from the Supreme Court and other Circuits. It is "well-settled" that amendments by implication "are disfavored," *United States v. Welden*, 377 U.S. 95, 103

n. 12 (1964), and will not be upheld in doubtful cases nor when they raise constitutional questions. *St. Martin Lutheran Church v. South Dakota*, 451 U.S. 772, 786-788 (1981); *Patel v. Quality Inn South*, 846 F.2d 700, 704 (11th Cir. 1988); *Galvan v. Hess Oil Virgin Is. Corp.*, 549 F.2d 281, 288 (3rd Cir. 1977). *Also see NLRB v. Catholic Bishop of Chicago*, 440 U.S. 490 (1979).

Murphy II also conflicts with the "long-established canon of construction" that in the absence of "clear and manifest" Congressional intent to amend a statute by implication, "the only permissible justification for a repeal [or amendment] by implication is when the earlier and later statutes are irreconcilable." *St. Martin Evangelical Lutheran Church*, 451 U.S. at 788; *Morton v. Mancari*, 417 U.S. 535, 550-51 (1974) ("'courts are not at liberty to pick and choose among congressional enactments, and when two statutes are capable of coexistence, it is the duty of the courts, absent a clearly expressed congressional intention to the contrary, to regard each as effective.'"); *American Bank and Trust Co. v. Dallas County*, 463 U.S. 855, 868 (1983). Section 104(a)(2), as amended in 1996, is simply not "irreconcilable with" the earlier enacted Section 61(a). Under amended Section 104, any damages received on account of personal "physical" injuries and "physical" sickness are in fact excluded even if Section 61(a) is not amended, and the two statutes are clearly "capable of coexistence." *Morton*, 417 U.S. at 551.

There was no "clear and manifest" intent by Congress to amend Section 61(a) by implication when it amended Section 104(a)(2) in 1996. The only "evidence" of such legislative intent cited by the D.C. Circuit is the heading of a section of the House Report in support of the 1996 amendment to Section 104(a)(2). App. 22. Notably, the text of Section 104, as amended, was silent on whether Congress intended any change or extension of Section 61(a), and the actual text of the House Report was also silent. *See* Pub.L. 104-188, Title I, § 1605(a) to (c), 110 Stat. 1838; H.R. Rep. No. 104-586, at 143-44, *reprinted in* 1996-3 C.B. 331, 481-82. Headings contained in statutes do not evidence legislative intent. *Bhd. of R.R. Trainmen v. Balt. & Ohio R.R. Co.*, 331 U.S. 519, 528-29 (1947). Certainly, headings alone contained in legislative reports are deserving of even less weight than headings in statutes. Moreover, headings are by their very nature general statements and nothing more. *Id.*, 331 U.S. at 528-29. It is well-settled that general statements contained in legislative reports "are simply too general and too ambiguous to bear the weight [the panel] would assign to them." *St. Martin Evangelical Lutheran Church*, 451 U.S. at 786. Under such circumstances, the legislative history cited by the D.C. Circuit "does not reveal any clear intent" to amend Section 61(a), "or to alter its meaning." *Id.*, 451 U.S. at 787-88. Such "indefinite congressional expressions . . . cannot work a repeal or amendment by implication." *Id.*

D. Congress Did Not Enact An "Excise Tax" on Compensatory Damages and the D.C. Circuit's Interpretation of the Catchall Phrase of Section 61(a) To Imply Such A Tax Conflicts with Cases of Other Circuits and of the Supreme Court.

The D.C. Circuit's decision on the Article I issue conflicts with cases of the Supreme Court and cases of other circuits. Because Murphy's damages are not income under either Section 61(a) or the Sixteenth Amendment, whether such damages could be taxable under Article I if Congress actually enacted a separate tax on damages is purely a hypothetical question. As stated above, Murphy's damages are not income under the catchall provision of Section 61 or the Sixteenth Amendment (*see, e.g., Glenshaw Glass, supra.*), and Congress never enacted a separate tax on these types of damages. *Cf. Gould, supra.* Congress has not actually passed a tax on compensatory damages so there is no case or controversy as to whether such a tax could be constitutionally imposed under Article I. Moreover, in this case, there is simply no nexus between Article I and a statute to levy a tax on Murphy's damages because Congress failed to enact a statute to levy a tax on compensatory damages.[5] The catchall provision of Section 61(a) cannot be

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[5] Dodge, Joseph M., "The Constitutionality of Federal Taxes and Federal Tax Provisions," pp. 8-9 (November 12, 2006), Florida State University College of Law, Public Law Research Paper No. 226, *available at* http://ssrn.com/abstract=943014 ("Nevertheless, the *Murphy* [*I*] panel appears correct in stating that the catch-all clause of section 61 is limited by the meaning

(Continued on following page)

relied on to tax compensatory damages because the catchall clause was not invoked by Congress in 1996 and it reaches only "accessions to wealth" as "income," and does not create an "excise tax."[6] The only way the D.C. Circuit in *Murphy II* arrives at the Article I question is by finding an amendment to Section 61(a) by implication; however, the implied tax is not valid. *See* Section I.C., *supra*.

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of the term 'income' as used in the [Sixteenth] Amendment . . . [T]he issue of the statutory includibility of such damages falls within the catch-all clause, which states that the item is includible (only) if it is 'income.' If it is not 'income,' it is not taxed under the statute. If Congress, in the catch-all clause, has there exercised the full measure of taxing power, that power (as to that clause) must derive from the Sixteenth Amendment and be coextensive with it. The fact that other clauses might derive their power (in whole or in part) from the power to impose indirect taxes is beside the point with regard to the Murphy facts . . . [I]f an item is potentially taxable *only* under the catch-all clause of section 61(a), then it *must* pass the income test, and it cannot be bootstrapped into validity as being potentially the subject of a hypothetical (but non-existent) provision that would be valid as an indirect tax . . . If no Code provision specifically includes the item in income (or otherwise requires it to be taxed), its inclusion rests on whether the item is 'income' within the catch-all clause of section 61, with the latter (in turn) being limited by the 16th Amendment meaning of 'income.'") (Emphasis in original).

[6] The D.C. Circuit's reliance on *Penn Mut. Indemnity Co. v. Comm'r.*, 277 F.2d 16, 20 (3rd Cir. 1960), is misplaced because Congress actually passed a tax levying statute, Section 207 of the Internal Revenue Code of 1939, which imposed a tax of one percent tax on mutual insurance companies. Moreover, *Penn Mut. Indemnity* does not concern the interpretation of the catchall provision of Section 61(a) or the extension of a tax levying statute by implication.

The D.C. Circuit's "forced" sale formulation (App. 34), raised *sua sponte,* directly conflicts with the concept of "make whole" compensatory relief to remedy whistleblower retaliation under federal law,[7] and impermissibly confers a right on the wrongdoer. This holding overlooks the long-standing principle that a person cannot be forced to sell one's health, which is not a saleable commodity. The D.C. Circuit analogizes the "forced" sale of Murphy's mental health to the involuntary conversion of property into cash under 26 U.S.C. § 1033. App. 34. But this is not a § 1033 case at all. That provision applies only to the sale of "property" and conflicts with the D.C. Circuit's conclusion that the tax at issue in *Murphy* is not a tax on ownership of property. App. 33-36.

The D.C. Circuit's holding is even more troubling because such a "forced sale" of human health would be void and could not be enforced by the courts as a matter of law and public policy. An employer that violates an employee's federal statutory rights and caused injuries to the employee cannot utilize the courts to enforce an involuntary sale of the employee's health as envisioned by *Murphy II*. That would confer a benefit on the wrongdoer and diminish the employee's statutory damages and access to the legal system to vindicate federal statutory rights.

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[7] Each of the six federal environmental statutes upon which Murphy's whistleblower complaint was based specifically provide for an award of tort-type "make whole" compensatory damages. App. 83.

Additionally, the implied "excise tax" is unfounded because, unlike the cases relied on by the D.C. Circuit, Congress did not actually enact an applicable "excise tax" in this case. Notably, that portion of *Knowlton v. Moore,* cited by the D.C. Circuit, did not concern a federal "excise tax" on a "'creature of law'" at all, but rather state inheritance taxes imposed under state constitutions. *Cf.*, App. 36; *Knowlton v. Moore*, 178 U.S. 41, 55 (1900), quoting *Magoun v. Illinois Trust & Sav. Bank*, 170 U.S. 283, 287 (1898). The D.C. Circuit's reliance on *Steward Mach. Co. v. Davis*, 301 U.S. 548, 580-81 (1937), is also misplaced as the tax at issue there was a tax on conducting business.

None of the cases support the novel creation by the D.C. Circuit of an implied "excise tax" on plaintiffs for using the legal system to vindicate individual rights. In each of the cases cited by the D.C. Circuit (App. 33-36), Congress enacted separate statutes expressly imposing the excise taxes at issue. *See, Simmons v. United States*, 308 F.2d 160 (4th Cir. 1962) (26 U.S.C. § 74, prizes); *Penn Mut. Indemnity Co., supra.* (26 U.S.C. § 207, I.R.C. 1939); *Thomas v. U.S.*, 192 U.S. 363 (1904) (stamp tax of 1898 on sale of stock); *Bromley v. McCaughn*, 280 U.S. 124 (1929) (26 U.S.C. § 1131, gift tax); *Tyler v. United States*, 281 U.S. 497 (1930) (tax upon the transfer of the net estate imposed by Section 201 of the Revenue Acts of 1916); *Nicol v. Ames,* 173 U.S. 509 (1899) (Internal Revenue Act of 1898, taxing sales at exchanges,

boards of trade, etc.); *Knowlton, supra.* (tax on legacies and distributive shares passing at death). However, Section 61(a), at issue here, is a gross income statute and by its very terms does not impose an excise tax on compensatory damages.

Certainly, had Congress intended to enact an excise tax on damages for the "privilege" of using the legal system to vindicate statutory rights that intent would have been expressly stated. Such an excise tax also raises other important questions, such as what is the tax rate for such an implied "excise"? Also, does this judicially-implied "excise tax" apply equally to all damages recovered through the legal system, or only to the kind of damages obtained by Murphy? Does the "excise" fall on defendants, or only on successful plaintiffs? *Murphy II* creates a separation of powers issue, because under Article I taxes must be imposed by Congress, and not by the courts, particularly on matters as controversial as taxing civil rights plaintiffs for the "privilege" of utilizing the legal system. *Ellis,* 416 F.2d at 897. *Also see, Commissioner of Internal Rev. v. Brown*, 380 U.S. 563, 579 (1965).

Murphy II also renders the Sixteenth Amendment meaningless, and conflicts with precedents supporting that a tax on Murphy's damages is an invalid direct tax. The Supreme Court invalidated the entire income tax in 1895 when it was deemed to be a direct tax. *Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429 (1895), vacated on rehearing 158 U.S. 601 (1895); *Union Elec. Co. v. United States*, 363 F.3d 1292 (Fed. Cir. 2004), *cert. denied*, 543 U.S. 821

(2004). The D.C. Circuit's holding conflicts with these cases and violates the direct tax/apportionment clauses. Constitution, Article I, § 9, clause 4, and Article I, § 2. Taxing damages awarded for personal injuries to restore health or reputation is a direct tax on the person, because the money is intended to make a person whole for a human capital loss. "Make whole" remedies to restore a personal injury or human capital loss are analogous to a return of capital, and a tax on a return of capital is a direct tax. Taxing the money paid to return the capital is a tax on the capital itself.

E. The D.C. Circuit's Decision Conflicts with the Supreme Court's test in *Schleier*.

The D.C. Circuit's ruling also conflicts with the Supreme Court's test applying Section 104(a)(2), because in this case Ms. Murphy received damages on account of physical injuries and physical sickness within the meaning of the exclusion. *See Comm'r. of Internal Revenue v. Schleier*, 515 U.S. 323, 336-37 (1995). The labeling of the award as emotional distress damages is not dispositive. *See, e.g., Fabry v. CIR*, 223 F.3d 1261, 1269-1271 (11th Cir. 2000); *Brown v. United States*, 890 F.2d 1329, 1342 (5th Cir. 1989). This is particularly true where, as here, the record supporting that award expressly cited evidence of Murphy's physical problems, and where the physical problems were considered to be intertwined with and resulting from the emotional distress. Indeed, the district court found, based on the summary judgment

record in this case, that Murphy suffered physical injuries and physical manifestations resulting from the emotional distress caused by NYANG's illegal acts. App. 74, 85.

The plain meaning of the statute excludes from gross income any damages received on account of "physical injuries or physical sickness" regardless of what caused the injury or sickness. Nothing in the statute remotely suggests that an injury must be caused by physical stimuli for the exclusion to apply. *See* 26 U.S.C. § 104(a)(2). While the amended statute now states that "emotional distress shall not be treated as a physical injury or physical sickness," 26 U.S.C. § 104(a), the uncontested factual record establishes that Ms. Murphy suffered physical injuries, including permanent injury to her teeth, and, under the *Schleier* test, she received damages on account of those injuries.

To be sure, section 104(a), as amended, distinguishes between "physical injuries or physical sickness" and "emotional distress." But if the amended statute is to have any meaningful purpose, there must be a distinction between "physical injuries or physical sickness" and "emotional distress" and use of the term "physical symptoms" as used in the legislative history to define "emotional distress." *See BedRoc Ltd., LLC v. United States*, 541 U.S. 176 (2004); *Lamie v. United States Tr.*, 540 U.S. 526 (2004); *U.S. ex rel. Totten*, 380 F.3d at 494. The D.C. Circuit's decision conflicts with cases adopting the approach under the *Restatement (Second) of Torts*, which draws a "line between mere emotional disturbance and physical harm which results from emotional distress."

See, e.g., Walters v. Mintec/International, 758 F.2d 73, 77-78 (3rd Cir. 1985), citing *Restatement (Second) of Torts,* §§ 7, 402A, and 436A. There is a difference between "transitory" symptoms such as "dizziness" or nausea, and other "long continued" physical problems that "may amount to a physical illness" and which, in themselves, constitute "bodily harm." *Restatement (Second) of Torts*, § 436A. In this case, the D.C. Circuit ignored altogether that Murphy did suffer a physical injury or physical sickness for which she was awarded damages, and thus decided this case in a way that conflicts with *Schleier*.

II. THE QUESTIONS PRESENTED ARE IMPORTANT AND THERE IS NO REASON TO DEFER REVIEW.

Unquestionably, the questions presented are important as the D.C. Circuit held this case meets the standard of "exceptional circumstances" and "affects the broad public interest." App. 6. Also, the D.C. Circuit's holding has widespread ramifications and a broad impact on taxpayers, employers and employees in a wide range of cases, including but not limited to discrimination, civil rights, whistleblower and tort cases. The conflicting D.C. Circuit opinions in this case are the subject of much commentary due to the exceptional importance of taxing "make whole" compensatory damages, such as for emotional distress and loss of reputation in a broad range of cases.

For over 78 years, the IRS and the courts did not consider non-physical "make whole" awards for emotional distress and loss of reputation to be income,

because such damages are akin to a restoration of capital, and they restore a loss.

Indeed, the IRS regulations implementing Section 104(a) have not been revised since the 1996 amendments, and specifically state that "*Section 104(a)(2) excludes from gross income the amount of any damages received* (whether by suit or agreement) *on account of personal injuries or sickness.*" 26 C.F.R. § 1.104-1(c) (2005) (emphasis added). Thus, the IRS's own regulations actually inform taxpayers that "any" personal injury or sickness damages are exempt from gross income. *Id.*

Unquestionably, these issues are of paramount interest to both sides of the employment bar and to the employees who receive, and the businesses that pay, these kinds of damages in civil rights and whistleblower cases. David L. Hudson, Jr., "D.C. Circuit Strikes Down Tax On Emotional Damages," 35 A.B.A.J. E-Report 1 (Sept. 1, 2006) (noting *Murphy I* is "positive" for employers and employees and will promote settlement). Although some members of the tax bar and academia impulsively criticized *Murphy I,* claiming it would encourage tax protesters, at least one commentator concedes that reaction was overblown. 132 BNA Daily Tax Report, "Tax Decisions and Rulings," p. K-1 (July 11, 2007) (noting one commentator's observation that "criticism of the initial Murphy ruling may have been a little too enthusiastic, especially the claim that it would encourage tax protestors" because tax protesters will make their own arguments anyway). *Also see* Romond, Russell F., "Note: Income, Taxes and the Constitution: Why the D.C. Circuit Court of Appeals Got It Right In *Murphy*

I]," 12 Fordham J. of Corp. & Fin. Law, 587, 593 (2007) (Noting initial criticism by tax professors and others "to denounce" *Murphy I* as "flawed," "odd," "bizarre," and "horrible.").

However, after *Murphy II* there remains "confusion and ambiguity," and because the D.C. Circuit really did not repudiate anything in *Murphy I*, the unresolved issues will "fuel tax cases for years to come." Robert W. Wood, "Waiting to Exhale: *Murphy* Part Deux and Taxing Damage Awards," Vol. 116, No. 4, *Tax Notes*, 265 (July 23, 2007). Notably, other commentators have published articles pointing out that the D.C. Circuit was correct in *Murphy I*, while other commentators have published articles taking the opposite view. *See, e.g.,* Wood, *supra.*, Vol. 116, No. 4, *Tax Notes* at 265; Romond, *supra.*, 12 Fordham J. of Corp. & Fin. Law, at 593; Steven T. O'Hara, "Thinking Outside the Code," Vol. 116, No. 6, *Tax Notes* (Aug. 20, 2007); "Case Commentaries," 8 Transactions: Tenn. J. Bus. L. 445, 474 (2007); Rose, Elizabeth, "Murphy's Mistakes: How the Circuit Court Should Analyze Section 104(a)(2) Upon Rehearing," 60 Tax Law 533 (2007); Germain, Gregory L., "Taxing Emotional Injury Recoveries: A Critical Analysis of Murphy v. Internal Revenue Service," 60 Ark. L. Rev. 185 (2007); Fatino, John F., "The Tax Treatment of Verdicts and Settlements Following the Adoption of the Jobs Creation Act of 2004: Paradise Found for the Employment Lawyer?" 27 N. Ill. U. L. Rev. 1 (2006); Robert W. Wood, "Top Ten Reasons Why 'Murphy' Is My Favorite Tax Case," Vol. 190, No. 1, *Daily Tax Report* (BNA Oct. 2, 2006) (*Murphy I*'s "teachings may help generations of taxpayers.").

Regardless, the widespread attention and commentary that the *Murphy* case has generated indicates the importance of the case and underscores why, more than a decade after Section 104(a) was amended in 1996, there is no reason to delay review of the questions presented.

The Writ should be granted to resolve uncertainties about whether personal injury damages are taxable and decide, consistent with nearly 80 years of case law, that the "make whole" personal injury damages are not "income," and thus are not taxable.

CONCLUSION

For the foregoing reasons, this Petition for a Writ of Certiorari should be granted.

Respectfully submitted,

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United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued April 23, 2007 Decided July 3, 2007

No. 05-5139

MARRITA MURPHY AND
DANIEL J. LEVEILLE,
APPELLANTS

v.

INTERNAL REVENUE SERVICE AND
UNITED STATES OF AMERICA,
APPELLEES

Appeal from the United States District Court
for the District of Columbia
(No. 03cv02414)

On Rehearing

David K. Colapinto argued the cause for appellants. With him on the briefs were Stephen M. Kohn and Michael D. Kohn.

Richard R. Renner was on the brief for amici curiae No FEAR Coalition, et al. in support of appellants.

Gilbert S. Rothenberg, Attorney, U.S. Department of Justice, argued the cause for appellees. With him on the brief were Jeffrey A. Taylor, U.S. Attorney,

Richard T. Morrison, Deputy Assistant Attorney General, and Kenneth L. Greene and Francesca U. Tamami, Attorneys. Bridget M. Rowan, Attorney, entered an appearance.

Before: GINSBURG, *Chief Judge*, and ROGERS and BROWN, *Circuit Judges*.

Opinion for the Court filed by *Chief Judge* GINSBURG.

GINSBURG, *Chief Judge*: Marrita Murphy brought this suit to recover income taxes she paid on the compensatory damages for emotional distress and loss of reputation she was awarded in an administrative action she brought against her former employer. Murphy contends that under § 104(a)(2) of the Internal Revenue Code (IRC), 26 U.S.C. § 104(a)(2), her award should have been excluded from her gross income because it was compensation received "on account of personal physical injuries or physical sickness." She also maintains that, in any event, her award is not part of her gross income as defined by § 61 of the IRC, 26 U.S.C. § 61. Finally, she argues that taxing her award subjects her to an unapportioned direct tax in violation of Article I, Section 9 of the Constitution of the United States.

We reject Murphy's argument in all aspects. We hold, first, that Murphy's compensation was not "received . . . on account of personal physical injuries" excludable from gross income under § 104(a)(2). Second, we conclude gross income as defined by § 61 includes compensatory damages for non-physical

injuries. Third, we hold that a tax upon such damages is within the Congress's power to tax.

I. Background

In 1994 Marrita Leveille (now Murphy) filed a complaint with the Department of Labor alleging that her former employer, the New York Air National Guard (NYANG), in violation of various whistleblower statutes, had "blacklisted" her and provided unfavorable references to potential employers after she had complained to state authorities of environmental hazards on a NYANG airbase. The Secretary of Labor determined the NYANG had unlawfully discriminated and retaliated against Murphy, ordered that any adverse references to the taxpayer in the files of the Office of Personnel Management be withdrawn, and remanded her case to an Administrative Law Judge "for findings on compensatory damages."

On remand Murphy submitted evidence that she had suffered both mental and physical injuries as a result of the NYANG's blacklisting her. A psychologist testified that Murphy had sustained both "somatic" and "emotional" injuries, basing his conclusion in part upon medical and dental records showing Murphy had "bruxism," or teeth grinding often associated with stress, which may cause permanent tooth damage. Noting that Murphy also suffered from other "physical manifestations of stress" including "anxiety attacks, shortness of breath, and dizziness," and that Murphy testified she "could not concentrate, stopped

talking to friends, and no longer enjoyed 'anything in life,'" the ALJ recommended compensatory damages totaling $70,000, of which $45,000 was for "past and future emotional distress," and $25,000 was for "injury to [Murphy's] vocational reputation" from having been blacklisted. None of the award was for lost wages or diminished earning capacity.

In 1999 the Department of Labor Administrative Review Board affirmed the ALJ's findings and recommendations. *See Leveille v. N.Y. Air Nat'l Guard*, 1999 WL 966951, at *2-*4 (Oct. 25, 1999). On her tax return for 2000, Murphy included the $70,000 award in her "gross income" pursuant to § 61 of the IRC. *See* 26 U.S.C. § 61(a) ("[G]ross income means all income from whatever source derived"). As a result, she paid $20,665 in taxes on the award.

Murphy later filed an amended return in which she sought a refund of the $20,665 based upon § 104(a)(2) of the IRC, which provides that "gross income does not include . . . damages . . . received . . . on account of personal physical injuries or physical sickness." In support of her amended return, Murphy submitted copies of her dental and medical records. Upon deciding Murphy had failed to demonstrate the compensatory damages were attributable to "physical injury" or "physical sickness," the Internal Revenue Service denied her request for a refund. Murphy thereafter sued the IRS and the United States in the district court.

In her complaint Murphy sought a refund of the $20,665, plus applicable interest, pursuant to the Sixteenth Amendment to the Constitution of the United States, along with declaratory and injunctive relief against the IRS pursuant to the Administrative Procedure Act and the Due Process Clause of the Fifth Amendment. She argued her compensatory award was in fact for "physical personal injuries" and therefore excluded from gross income under § 104(a)(2). In the alternative Murphy asserted taxing her award was unconstitutional because the award was not "income" within the meaning of the Sixteenth Amendment. The Government moved to dismiss Murphy's suit as to the IRS, contending the Service was not a proper defendant, and for summary judgment on all claims.

The district court denied the Government's motion to dismiss, holding that Murphy had the right to bring an "action[ ] for declaratory judgments or . . . [a] mandatory injunction" against an "agency by its official title," pursuant to § 703 of the APA, 5 U.S.C. § 703. *Murphy v. IRS*, 362 F. Supp. 2d 206, 211-12, 218 (2005). The court then rejected all of Murphy's claims on the merits and granted summary judgment for the Government and the IRS. *Id.*

Murphy appealed the judgment of the district court with respect to her claims under § 104(a)(2) and the Sixteenth Amendment. In *Murphy v. IRS*, 460 F.3d 79 (2006), we concluded Murphy's award was not exempt from taxation pursuant to § 104(a)(2), *id.* at 84, but also was not "income" within the meaning of

the Sixteenth Amendment, *id.* at 92, and therefore reversed the decision of the district court. The Government petitioned for rehearing en banc, arguing for the first time that, even if Murphy's award is not income, there is no constitutional impediment to taxing it because a tax on the award is not a direct tax and is imposed uniformly. In view of the importance of the issue thus belatedly raised, the panel sua sponte vacated its judgment and reheard the case. *See Consumers Union of U.S., Inc. v. Fed. Power Comm'n*, 510 F.2d 656, 662 (D.C. Cir. 1975) ("[R]egarding the contents of briefs on appeal, we may also consider points not raised in the briefs or in oral argument. Our willingness to do so rests on a balancing of considerations of judicial orderliness and efficiency against the need for the greatest possible accuracy in judicial decisionmaking. The latter factor is of particular weight when the decision affects the broad public interest.") (footnotes omitted); *see also Eli Lilly & Co. v. Home Ins. Co.*, 794 F.2d 710, 717 (D.C. Cir. 1986) ("The rule in this circuit is that litigants must raise their claims on their initial appeal and not in subsequent hearings following a remand. This is a specific application of the general waiver rule, which bends only in 'exceptional circumstances, where injustice might otherwise result.'") (quoting *Dist. of Columbia v. Air Florida, Inc.*, 750 F.2d 1077, 1085 (D.C. Cir. 1984)) (citation omitted). In the present opinion, we affirm the judgment of the district court based upon the newly argued ground that Murphy's award, even if it is not income within the meaning of the Sixteenth Amendment, is within the reach of the congressional

power to tax under Article I, Section 8 of the Constitution.

II. Analysis

We review the district court's grant of summary judgment de novo, *Flynn v. R.C. Tile*, 353 F.3d 953, 957 (D.C. Cir. 2004), bearing in mind that summary judgment is appropriate only "if there is no genuine issue as to any material fact and if the moving party is entitled to judgment as a matter of law," *Anderson v. Liberty Lobby, Inc.*, 477 U.S. 242, 250 (1986). Before addressing Murphy's claims on their merits, however, we must determine whether the district court erred in holding the IRS was a proper defendant.

A. The IRS as a Defendant

The Government contends the courts lack jurisdiction over Murphy's claims against the IRS because the Congress has not waived that agency's immunity from declaratory and injunctive actions pursuant to 28 U.S.C. § 2201(a) (courts may grant declaratory relief "except with respect to Federal taxes") and 26 U.S.C. § 7421(a) ("no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person"); and insofar as the Congress in 28 U.S.C. § 1346(a)(1) has waived immunity from civil actions seeking tax refunds, that provision on its face applies to "civil action[s] against the United States," not against the IRS. In reply

Murphy argues only that the Government forfeited the issue of sovereign immunity because it did not cross-appeal the district court's denial of its motion to dismiss. *See* FED. R. APP. P. 4(a)(3). Notwithstanding the Government's failure to cross-appeal, however, the court must address a question concerning its jurisdiction. *See Occidental Petroleum Corp. v. SEC*, 873 F.2d 325, 328 (D.C. Cir. 1989) ("As a preliminary matter . . . we must address the question of our jurisdiction to hear this appeal").

Murphy and the district court are correct that § 703 of the APA does create a right of action for equitable relief against a federal agency but, as the Government correctly points out, the Congress has preserved the immunity of the United States from declaratory and injunctive relief with respect to all tax controversies except those pertaining to the classification of organizations under § 501(c) of the IRC. *See* 28 U.S.C. § 2201(a); 26 U.S.C. § 7421(a). As an agency of the Government, of course, the IRS shares that immunity. *See Settles v. U.S. Parole Comm'n*, 429 F.3d 1098, 1106 (D.C. Cir. 2005) (agency "retains the immunity it is due as an arm of the federal sovereign"). Insofar as the Congress in 28 U.S.C. § 1346(a)(1) has waived sovereign immunity with respect to suits for tax refunds, that provision specifically contemplates only actions against the "United States." Therefore, we hold the IRS, unlike the United States, may not be sued *eo nomine* in this case.

B. Section 104(a)(2) of the IRC

Section 104(a) ("Compensation for injuries or sickness") provides that "gross income [under § 61 of the IRC] does not include the amount of any damages (other than punitive damages) received . . . on account of personal physical injuries or physical sickness." 26 U.S.C. § 104(a)(2). Since 1996 it has further provided that, for purposes of this exclusion, "emotional distress shall not be treated as a physical injury or physical sickness." *Id.* § 104(a). The version of § 104(a)(2) in effect prior to 1996 had excluded from gross income monies received in compensation for "personal injuries or sickness," which included both physical and nonphysical injuries such as emotional distress. *Id.* § 104(a)(2) (1995); *see United States v. Burke*, 504 U.S. 229, 235 n.6 (1992) ("[section] 104(a)(2) in fact encompasses a broad range of physical and nonphysical injuries to personal interests"). In *Commissioner v. Schleier*, 515 U.S. 323 (1995), the Supreme Court held that before a taxpayer may exclude compensatory damages from gross income pursuant to § 104(a)(2), he must first demonstrate that "the underlying cause of action giving rise to the recovery [was] 'based upon tort or tort type rights.'" *Id.* at 337. The taxpayer has the same burden under the statute as amended. *See, e.g., Chamberlain v. United States,* 401 F.3d 335, 341 (5th Cir. 2005).

Murphy contends § 104(a)(2), even as amended, excludes her particular award from gross income. First, she asserts her award was "based upon . . . tort

type rights" in the whistle-blower statutes the NYANG violated – a position the Government does not challenge. Second, she claims she was compensated for "physical" injuries, which claim the Government does dispute.

Murphy points both to her psychologist's testimony that she had experienced "somatic" and "body" injuries "as a result of NYANG's blacklisting [her]," and to the American Heritage Dictionary, which defines "somatic" as "relating to, or affecting the body, especially as distinguished from a body part, the mind, or the environment." Murphy further argues the dental records she submitted to the IRS proved she has suffered permanent damage to her teeth. Citing *Walters v. Mintec/International,* 758 F.2d 73, 78 (3d Cir. 1985), and *Payne v. Gen. Motors Corp.*, 731 F. Supp. 1465, 1474-75 (D. Kan. 1990), Murphy contends that "substantial physical problems caused by emotional distress are considered physical injuries or physical sickness."

Murphy further contends that neither § 104 of the IRC nor the regulation issued thereunder "limits the physical disability exclusion to a physical stimulus." In fact, as Murphy points out, the applicable regulation, which provides that § 104(a)(2)"excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness," 26 C.F.R. § 1.104-1(c), does not distinguish between physical injuries stemming from physical stimuli and those arising from emotional trauma; rather, it tracks the pre-1996 text

of § 104(a)(2), which the IRS agrees excluded from gross income compensation both for physical and for nonphysical injuries.

For its part, the Government argues Murphy's focus upon the word "physical" in § 104(a)(2) is misplaced; more important is the phrase "on account of." In *O'Gilvie v. United States*, 519 U.S. 79 (1996), the Supreme Court read that phrase to require a "strong[ ] causal connection," thereby making § 104(a)(2)"applicable only to those personal injury lawsuit damages that were awarded by reason of, or because of, the personal injuries." *Id.* at 83. The Court specifically rejected a "but-for" formulation in favor of a "stronger causal connection." *Id.* at 82-83. The Government therefore concludes Murphy must demonstrate she was awarded damages "because of" her physical injuries, which the Government claims she has failed to do.

Indeed, as the Government points out, the ALJ expressly recommended, and the Board expressly awarded, compensatory damages "because of" Murphy's nonphysical injuries. The Board analyzed the ALJ's recommendation under the headings "Compensatory damage for emotional distress or mental anguish" and "Compensatory damage award for injury to professional reputation," and noted such damages compensate "not only for direct pecuniary loss, but also for such harms as impairment of reputation, personal humiliation, and mental anguish and suffering." *Leveille*, 1999 WL 966951 at *2. In describing the ALJ's proposed award as "reasonable," the

Board stated Murphy was to receive "$45,000 for mental pain and anguish" and "$25,000 for injury to professional reputation." Although Murphy may have suffered from bruxism or other physical symptoms of stress, the Board focused upon Murphy's testimony that she experienced "severe anxiety attacks, inability to concentrate, a feeling that she no longer enjoyed 'anything in life,' and marital conflict" and upon her psychologist's testimony about the "substantial effect the negative references had on [Murphy]." *Id.* at *3. The Board made no reference to her bruxism, and acknowledged that "[a]ny attempt to set a monetary value on intangible damages such as mental pain and anguish involves a subjective judgment," *id.* at *4, before concluding the ALJ's recommendation was reasonable. The Government therefore argues "there was no direct causal link between the damages award at issue and [Murphy's] bruxism."

Murphy responds that it is undisputed she suffered both "somatic" and "emotional" injuries, and the ALJ and Board expressly cited to the portion of her psychologist's testimony establishing that fact. She contends the Board therefore relied upon her physical injuries in determining her damages, making those injuries a direct cause of her award in spite of the Board's labeling the award as one for emotional distress.

Although the pre-1996 version of § 104(a)(2) was at issue in *O'Gilvie,* the Court's analysis of the phrase "on account of," which phrase was unchanged by the 1996 Amendments, remains controlling here. Murphy

no doubt suffered from certain physical manifestations of emotional distress, but the record clearly indicates the Board awarded her compensation only "for mental pain and anguish" and "for injury to professional reputation." *Id.* at *5. Although the Board cited her psychologist, who had mentioned her physical aliments, in support of Murphy's "description of her mental anguish," we cannot say the Board, notwithstanding its clear statements to the contrary, actually awarded damages because of Murphy's bruxism and other physical manifestations of stress. *Id.* at *3. At best – and this is doubtful – at best the Board and the ALJ may have considered her physical injuries indicative of the severity of the emotional distress for which the damages were awarded, but her physical injuries themselves were not the reason for the award. The Board thus having left no room for doubt about the grounds for her award, we conclude Murphy's damages were not "awarded by reason of, or because of, . . . [physical] personal injuries," *O'Gilvie*, 519 U.S. at 83. Therefore, § 104(a)(2) does not permit Murphy to exclude her award from gross income.*

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* Insofar as compensation for nonphysical personal injuries appears to be excludable from gross income under 26 C.F.R. § 1.104-1, the regulation conflicts with the plain text of § 104(a)(2); in these circumstances the statute clearly controls. *See Brown v. Gardner*, 513 U.S. 115, 122 (1994) (finding "no antidote to [a regulation's] clear inconsistency with a statute").

C. Section 61 of the IRC

Murphy and the Government agree that for Murphy's award to be taxable, it must be part of her "gross income" as defined by § 61(a) of the IRC, which states in relevant part: "gross income means all income from whatever source derived." The Supreme Court has interpreted the section broadly to extend to "all economic gains not otherwise exempted." *Comm'r v. Banks*, 543 U.S. 426, 433 (2005); *see also, e.g.*, *James v. United States*, 366 U.S. 213, 219 (1961) (Section 61 encompasses "all accessions to wealth") (internal quotation mark omitted); *Comm'r v. Glenshaw Glass Co.*, 348 U.S. 426, 430 ("the Court has given a liberal construction to ["gross income"] in recognition of the intention of Congress to tax all gains except those specifically exempted"). "Gross income" in § 61(a) is at least as broad as the meaning of "incomes" in the Sixteenth Amendment.* *See Glenshaw Glass*, 348 U.S. at 429, 432 n.11 (quoting H.R.Rep. No. 83-1337, at A18 (1954), *reprinted in* 1954 U.S.C.C.A.N. 4017, 4155); *Helvering v. Bruun*, 309 U.S. 461, 468 (1940).

Murphy argues her award is not a gain or an accession to wealth and therefore not part of gross income. Noting the Supreme Court has long recognized "the principle that a restoration of capital [i]s

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* The Sixteenth Amendment provides: "The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration."

not income; hence it [falls] outside the definition of 'income' upon which the law impose[s] a tax," *O'Gilvie*, 519 U.S. at 84; *see, e.g.*, *Doyle v. Mitchell Bros. Co.*, 247 U.S. 179, 187-88 (1918); *S. Pac. Co. v. Lowe*, 247 U.S. 330, 335 (1918), Murphy contends a damage award for personal injuries – including nonphysical injuries – should be viewed as a return of a particular form of capital – "human capital," as it were. *See* Gary S. Becker, HUMAN CAPITAL (1st ed. 1964); Gary S. Becker, The Economic Way of Looking at Life, Nobel Lecture (Dec. 9, 1992), *in* NOBEL LECTURES IN ECONOMIC SCIENCES 1991-1995, at 43-45 (Torsten Persson ed., 1997). In her view, the Supreme Court in *Glenshaw Glass* acknowledged the relevance of the human capital concept for tax purposes. There, in holding that punitive damages for personal injury were "gross income" under the predecessor to § 61, the Court stated:

> The long history of . . . holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages following injury to property. . . . Damages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes.

348 U.S. at 432 n.8. By implication, Murphy argues, damages for personal injury are a "restoration of capital."

As further support, Murphy cites various administrative rulings issued shortly after passage of the Sixteenth Amendment that concluded recoveries from personal injuries were not income, such as this 1918 Opinion of the Attorney General:

> Without affirming that the human body is in a technical sense the "capital" invested in an accident policy, in a broad, natural sense the proceeds of the policy do but substitute, so far as they go, capital which is the source of future periodical income. They merely take the place of capital in human ability which was destroyed by the accident. They are therefore "capital" as distinguished from "income" receipts.

31 Op. Att'y Gen. 304, 308; *see* T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918); Sol. Op. 132, I-1 C.B. 92, 93-94 (1922) ("[M]oney received . . . on account of . . . defamation of personal character . . . does not constitute income within the meaning of the sixteenth amendment and the statutes enacted thereunder"). She also cites a House Report on the bill that became the Revenue Act of 1918. H.R.Rep. No. 65-767, at 9-10 (1918) ("Under the present law it is doubtful whether amounts received . . . as compensation for personal injury . . . are required to be included in gross income"); *see also Dotson v. United States*, 87 F.3d 682, 685 (5th Cir. 1996) (concluding on basis of House Report that the "Congress first enacted the personal injury compensation exclusion . . . when such payments were considered the return of human capital,

and thus not constitutionally taxable 'income' under the 16th amendment").

Finally, Murphy argues her interpretation of § 61 is reflected in the common law of tort and the provisions in various environmental statutes and Title VII of the Civil Rights Act of 1964, all of which provide for "make whole" relief. *See, e.g.*, 42 U.S.C. § 1981a; 15 U.S.C. § 2622. If a recovery of damages designed to "make whole" the plaintiff is taxable, she reasons, then one who receives the award has not been made whole after tax. Section 61 should not be read to create a conflict between the tax code and the "make whole" purpose of the various statutes.

The Government disputes Murphy's interpretation on all fronts. First, noting "the definition [of gross income in the IRC] extends broadly to all economic gains," *Banks*, 543 U.S. at 433, the Government asserts Murphy "undeniably had economic gain because she was better off financially after receiving the damages award than she was prior to receiving it." Second, the Government argues that the case law Murphy cites does not support the proposition that the Congress lacks the power to tax as income recoveries for personal injuries. In its view, to the extent the Supreme Court has addressed at all the taxability of compensatory damages, *see, e.g.*, *O'Gilvie*, 519 U.S. at 86; *Glenshaw Glass*, 348 U.S. at 432 n.8, it was merely articulating the Congress's rationale at the time for not taxing such damages, not the Court's own view whether such damages could constitutionally be taxed.

Third, the Government challenges the relevance of the administrative rulings Murphy cites from around the time the Sixteenth Amendment was ratified; Treasury decisions dating from even closer to the time of ratification treated damages received on account of personal injury as income. *See* T.D. 2135, 17 Treas. Dec. Int. Rev. 39, 42 (1915); T.D. 2690, Reg. No. 33 (Rev.), art. 4, 20 Treas. Dec. Int. Rev. 126, 130 (1918). Furthermore, administrative rulings from the time suggest that, even if recoveries for physical personal injuries were not considered part of income, recoveries for nonphysical personal injuries were. *See* Sol. Mem. 957, 1 C.B. 65 (1919) (damages for libel subject to income tax); Sol. Mem. 1384, 2 C.B. 71 (1920) (recovery of damages from alienation of wife's affections not regarded as return of capital, hence taxable). Although the Treasury changed its position in 1922, *see* Sol. Op. 132, I-1 C.B. at 93-94, it did so only after the Supreme Court's decision in *Eisner v. Macomber*, 252 U.S. 189 (1920), which the Court later viewed as having established a definition of income that "served a useful purpose [but] was not meant to provide a touchstone to all future gross income questions." *Glenshaw Glass*, 348 U.S. at 430-31. As for Murphy's contention that reading § 61 to include her damages would be in tension with the common law and various statutes providing for "make whole" relief, the Government denies there is any tension and suggests Murphy is trying to turn a disagreement over tax policy into a constitutional issue.

Finally, the Government argues that even if the concept of human capital is built into § 61, Murphy's award is nonetheless taxable because Murphy has no tax basis in her human capital. Under the IRC, a taxpayer's gain upon the disposition of property is the difference between the "amount realized" from the disposition and his basis in the property, 26 U.S.C. § 1001, defined as "the cost of such property," *id.* § 1012, adjusted "for expenditures, receipts, losses, or other items, properly chargeable to [a] capital account," *id.* § 1016(a)(1). The Government asserts, "The Code does not allow individuals to claim a basis in their human capital"; accordingly, Murphy's gain is the full value of the award. *See Roemer v. Comm'r*, 716 F.2d 693, 696 n.2 (9th Cir. 1983) ("Since there is no tax basis in a person's health and other personal interests, money received as compensation for an injury to those interests might be considered a realized accession to wealth") (dictum).

Although Murphy and the Government focus primarily upon whether Murphy's award falls within the definition of income first used in *Glenshaw Glass*,* coming within that definition is not the only

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* Murphy also suggests further insight into whether her award is income can be gleaned from application of the "in lieu of" test. *See Raytheon Prod. Corp. v. Comm'r*, 144 F.2d 110, 113 (1st Cir. 1944). As she acknowledges, however, we would still be required to determine whether her award was compensatory or an accession to wealth, which is the same analysis *Glenshaw Glass* and its progeny demand. As discussed below, it is unnecessary to

(Continued on following page)

way in which § 61(a) could be held to encompass her award. Principles of statutory interpretation could show § 61(a) includes Murphy's award in her gross income regardless whether it was an "accession to wealth," as *Glenshaw Glass* requires. For example, if § 61(a) were amended specifically to include in gross income "$100,000 in addition to all other gross income," then that additional sum would be a part of gross income under § 61 even though no actual gain was associated with it. In other words, although the "Congress cannot make a thing income which is not so in fact," *Burk-Waggoner Oil Ass'n v. Hopkins*, 269 U.S. 110, 114 (1925), it can *label* a thing income and tax it, so long as it acts within its constitutional authority, which includes not only the Sixteenth Amendment but also Article I, Sections 8 and 9. *See Penn Mut. Indem. Co. v. Comm'r*, 277 F.2d 16, 20 (3d Cir. 1960) ("Congress has the power to impose taxes generally, and if the particular imposition does not run afoul of any constitutional restrictions then the tax is lawful, call it what you will") (footnote omitted). Accordingly, rather than ask whether Murphy's award was an accession to her wealth, we go to the heart of the matter, which is whether her award is properly included within the definition of gross income in § 61(a), to wit, "all income from whatever source derived."

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determine if there was an accession to wealth in this case; § 61 encompasses Murphy's award regardless.

Looking at § 61(a) by itself, one sees no indication that it covers Murphy's award unless the award is "income" as defined by *Glenshaw Glass* and later cases. Damages received for emotional distress are not listed among the examples of income in § 61 and, as Murphy points out, an ambiguity in the meaning of a revenue-raising statute should be resolved in favor of the taxpayer. *See, e.g., Hassett v. Welch*, 303 U.S. 303, 314 (1938); *Gould v. Gould*, 245 U.S. 151, 153 (1917); *see also United Dominion Indus., Inc. v. United States*, 532 U.S. 822, 839 (2001) (Thomas, J., concurring); *id.* at 839 n.1 (Stevens, J., dissenting); 3A NORMAN J. SINGER, SUTHERLAND STATUTES & STATUTORY CONSTRUCTION § 66:1 (6th ed. 2003). A statute is to be read as a whole, however, *see, e.g., Alaska Dep't of Envtl. Conservation v. EPA*, 540 U.S. 461, 489 n.13 (2004), and reading § 61 in combination with § 104(a)(2) of the Internal Revenue Code presents a very different picture – a picture so clear that we have no occasion to apply the canon favoring the interpretation of ambiguous revenue-raising statutes in favor of the taxpayer.

As noted above, in 1996 the Congress amended § 104(a) to narrow the exclusion to amounts received on account of "personal physical injuries or physical sickness" from "personal injuries or sickness," and explicitly to provide that "emotional distress shall not be treated as a physical injury or physical sickness," thus making clear that an award received on account of emotional distress is not excluded from gross income under § 104(a)(2). Small Business Job Protection Act of

1996, Pub. L. 104-188, § 1605, 110 Stat. 1755, 1838. As this amendment, which narrows the exclusion, would have no effect whatsoever if such damages were not included within the ambit of § 61, and as we must presume that "[w]hen Congress acts to amend a statute, . . . it intends its amendment to have real and substantial effect," *Stone v. INS*, 514 U.S. 386, 397 (1995), the 1996 amendment of § 104(a) strongly suggests § 61 should be read to include an award for damages from nonphysical harms.* Although it is unclear whether § 61 covered such an award before 1996, we need not address that question here; even if the provision did not do so prior to 1996, the presumption indicates the Congress implicitly amended § 61 to cover such an award when it amended § 104(a).

We realize, of course, that amendments by implication, like repeals by implication, are disfavored. *United States v. Welden,* 377 U.S. 95, 103 n.12 (1964); *Cheney R.R. Co. v. R.R. Ret. Bd.*, 50 F.3d 1071, 1078 (D.C. Cir. 1995). The Supreme Court has also noted, however, that the "classic judicial task of reconciling many laws enacted over time, and getting them to 'make sense' in combination, necessarily assumes

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* As evidence the presumption is well-founded in this case, we note the House Report accompanying the 1996 amendment to § 104 explicitly presumes recoveries for nonphysical injuries would be included in gross income: Part of the section explaining the effect of the amendment is entitled "Include in income damage recoveries for nonphysical injuries." H.R. Rep. No. 104-586, at 143-44 (1996), *reprinted in* 1996-3 C.B. 331, 481-82.

that the implications of a statute may be altered by the implications of a later statute." *United States v. Fausto*, 484 U.S. 439, 453 (1988); *see also FDA v. Brown & Williamson Tobacco Corp.*, 529 U.S. 120, 133 (2000) ("[T]he meaning of one statute may be affected by other Acts, particularly where Congress has spoken subsequently and more specifically to the topic at hand"); *Almendarez-Torres v. United States*, 523 U.S. 224, 237 (1998) (suggesting later enacted laws "depend[ing] for their effectiveness upon clarification, or a change in the meaning of an earlier statute" provide a "forward looking legislative mandate, guidance, or direct suggestion about how courts should interpret the earlier provisions"); *cf. Franklin v. Gwinnett County Pub. Sch.*, 503 U.S. 60, 72-73 (1992) (amendment of Title IX abrogating States' Eleventh Amendment immunity validated Court's prior holding that Title IX created implied right of action); *id.* at 78 (Scalia, J., concurring in judgment) (amendment to Title IX was an "implicit acknowledgment that damages are available").

This "classic judicial task" is before us now. For the 1996 amendment of § 104(a) to "make sense," gross income in § 61(a) must, and we therefore hold it does, include an award for nonphysical damages such as Murphy received, regardless whether the award is an accession to wealth. *Cf. Vermont Agency of Natural Res. v. United States ex rel. Stevens*, 529 U.S. 765, 786 & n.17 (2000) (determining meaning of "person" in False Claims Act, which was originally enacted in 1863, based in part upon definition of "person" in

Program Fraud Civil Remedies Act of 1986, which was "designed to operate in tandem with the [earlier Act]").

D. The Congress's Power to Tax

The taxing power of the Congress is established by Article I, Section 8 of the Constitution: "The Congress shall have power to lay and collect taxes, duties, imposts and excises." There are two limitations on this power. First, as the same section goes on to provide, "all duties, imposts and excises shall be uniform throughout the United States." Second, as provided in Section 9 of that same Article, "No capitation, or other direct, tax shall be laid, unless in proportion to the census or enumeration herein before directed to be taken." *See also* U.S. CONST. art. I, § 2, cl. 3 ("direct taxes shall be apportioned among the several states which may be included within this union, according to their respective numbers").* We now consider whether the tax laid upon Murphy's award violates either of these two constraints.

1. A Direct Tax?

Over the years, courts have considered numerous claims that one or another nonapportioned tax is a

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* Though it is unclear whether an income tax is a direct tax, the Sixteenth Amendment definitively establishes that a tax upon income is not required to be apportioned. *See Stanton v. Baltic Mining Co.*, 240 U.S. 103, 112-13 (1916).

direct tax and therefore unconstitutional. Although these cases have not definitively marked the boundary between taxes that must be apportioned and taxes that need not be, *see Bromley v. McCaughn*, 280 U.S. 124, 136 (1929); *Spreckels Sugar Ref. Co. v. McClain*, 192 U.S. 397, 413 (1904) (dividing line between "taxes that are direct and those which are to be regarded simply as excises" is "often very difficult to be expressed in words"), some characteristics of each may be discerned.

Only three taxes are definitely known to be direct: (1) a capitation, U.S. CONST. art. I, § 9, (2) a tax upon real property, and (3) a tax upon personal property. *See Fernandez v. Wiener*, 326 U.S. 340, 352 (1945) ("Congress may tax real estate or chattels if the tax is apportioned"); *Pollock v. Farmers' Loan & Trust Co.*, 158 U.S. 601, 637 (1895) (*Pollock II*).** Such direct taxes are laid upon one's "general ownership of property," *Bromley*, 280 U.S. at 136; *see also Flint v. Stone Tracy Co.*, 220 U.S. 107, 149 (1911), as contrasted with excise taxes laid "upon a particular use or enjoyment of property or the shifting from one to another of any power or privilege incidental to the ownership or enjoyment of property." *Fernandez*, 326 U.S. at 352; *see also Thomas v. United States*, 192 U.S. 363, 370 (1904) (excises cover "duties imposed on

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** *Pollock II* also held that a tax upon the income of real or personal property is a direct tax. 158 U.S. at 637. Whether that portion of *Pollock* remains good law is unclear. *See Graves v. New York ex rel. O'Keefe*, 306 U.S. 466, 480 (1939).

importation, consumption, manufacture and sale of certain commodities, privileges, particular business transactions, vocations, occupations and the like"). More specifically, excise taxes include, in addition to taxes upon consumable items, *see Patton v. Brady*, 184 U.S. 608, 617-18 (1902), taxes upon the sale of grain on an exchange, *Nicol v. Ames*, 173 U.S. 509, 519 (1899), the sale of corporate stock, *Thomas*, 192 U.S. at 371, doing business in corporate form, *Flint*, 220 U.S. at 151, gross receipts from the "business of refining sugar," *Spreckels*, 192 U.S. at 411, the transfer of property at death, *Knowlton v. Moore*, 178 U.S. 41, 81-82 (1900), gifts, *Bromley*, 280 U.S. at 138, and income from employment, *see Pollock v. Farmers' Loan & Trust Co.*, 157 U.S. 429, 579 (1895) (*Pollock I*) (citing *Springer v. United States*, 102 U.S. 586 (1881)).

Murphy and the amici supporting her argue the dividing line between direct and indirect taxes is based upon the ultimate incidence of the tax; if the tax cannot be shifted to someone else, as a capitation cannot, then it is a direct tax; but if the burden can be passed along through a higher price, as a sales tax upon a consumable good can be, then the tax is indirect. This, she argues, was the distinction drawn when the Constitution was ratified. *See* Albert Gallatin, A Sketch of the Finances of the United States (1796), *reprinted in* 3 THE WRITINGS OF ALBERT GALLATIN 74-75 (Henry Adams ed., Philadelphia, J.P. Lippincott & Co. 1879) ("The most generally received opinion . . . is, that by direct taxes . . . those are

meant which are raised on the capital or revenue of the people; by indirect, such as are raised on their expense"); THE FEDERALIST NO. 36, at 225 (Alexander Hamilton) (Jacob E. Cooke ed., 1961) ("internal taxes[ ] may be subdivided into those of the *direct* and those of the *indirect* kind . . . by which must be understood duties and excises on articles of consumption"). *But see* Gallatin, *supra,* at 74 ("[Direct tax] is used, by different writers, and even by the same writers, in different parts of their writings, in a variety of senses, according to that view of the subject they were taking"); EDWIN R.A. SELIGMAN, THE INCOME TAX 540 (photo. reprint 1970) (2d ed. 1914) ("there are almost as many classifications of direct and indirect taxes are there are authors"). Moreover, the amici argue, this understanding of the distinction explains the different restrictions imposed respectively upon the power of the Congress to tax directly (apportionment) and via excise (uniformity). Duties, imposts, and excise taxes, which were expected to constitute the bulk of the new federal government's revenue, *see* Erik M. Jensen, *The Apportionment of "Direct Taxes": Are Consumption Taxes Constitutional?*, 97 COLUM. L. REV. 2334, 2382 (1997), have a built-in safeguard against oppressively high rates: Higher taxes result in higher prices and therefore fewer sales and ultimately lower tax revenues. *See* THE FEDERALIST NO. 21, *supra*, at 134-35 (Alexander Hamilton). Taxes that cannot be shifted, in contrast, lack this self-regulating feature, and were therefore constrained by the more stringent requirement of apportionment. *See id.* at 135 ("In a branch of taxation

where no limits to the discretion of the government are to be found in the nature of things, the establishment of a fixed rule . . . may be attended with fewer inconveniences than to leave that discretion altogether at large"); *see also* Jensen, *supra*, at 2382-84.

Finally, the amici contend their understanding of a direct tax was confirmed in *Pollock II*, where the Supreme Court noted that "the words 'duties, imposts, and excises' are put in antithesis to direct taxes," 158 U.S. at 622, for which it cited THE FEDERALIST NO. 36 (Hamilton). *Pollock II*, 158 U.S. at 624-25. As it is clear that Murphy cannot shift her tax burden to anyone else, per Murphy and the amici, it must be a direct tax.

The Government, unsurprisingly, backs a different approach; by its lights, only "taxes that are capable of apportionment in the first instance, specifically, capitation taxes and taxes on land," are direct taxes. The Government maintains that this is how the term was generally understood at the time. *See* Calvin H. Johnson, *Fixing the Constitutional Absurdity of the Apportionment of Direct Tax*, 21 CONST. COMM. 295, 314 (2004). Moreover, it suggests, this understanding is more in line with the underlying purpose of the tax and the apportionment clauses, which were drafted in the intense light of experience under the Articles of Confederation.

The Articles did not grant the Continental Congress the power to raise revenue directly; it could only requisition funds from the States. *See* ARTICLES OF

CONFEDERATION art. VIII (1781); Bruce Ackerman, *Taxation and the Constitution*, 99 COLUM. L. REV. 1, 6-7 (1999). This led to problems when the States, as they often did, refused to remit funds. *See* Calvin H. Johnson, *The Constitutional Meaning of "Apportionment of Direct Taxes,"* 80 TAX NOTES 591, 593-94 (1998). The Constitution redressed this problem by giving the new national government plenary taxing power. *See* Ackerman, *supra*, at 7. In the Government's view, it therefore makes no sense to treat "direct taxes" as encompassing taxes for which apportionment is effectively impossible, because "the Framers could not have intended to give Congress plenary taxing power, on the one hand, and then so limit that power by requiring apportionment for a broad category of taxes, on the other." This view is, according to the Government, buttressed by evidence that the purpose of the apportionment clauses was not in fact to constrain the power to tax, but rather to placate opponents of the compromise over representation of the slave states in the House, as embodied in the Three-fifths Clause.* *See* Ackerman, *supra*, at

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* Many Northern delegates were opposed to the three-fifths compromise on the ground that if slaves were property, then they should not count for the purpose of representation. Apportionment effectively meant that if the slaveholding states were to receive representation in the House for their slaves, then because apportioned taxes must be allocated across states based upon their representation, the slaveholding states would pay more in taxes to the national government than they would have if slaves were not counted at all in determining representation. *See* Ackerman, *supra*, at 9. Apportionment was then limited to

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10-11. *See generally* SELIGMAN, *supra*, at 548-55. As the Government interprets the historical record, the apportionment limitation was "more symbolic than anything else: it appeased the anti-slavery sentiment of the North and offered a practical advantage to the South as long as the scope of direct taxes was limited." *See* Ackerman, *supra*, at 10. *But see* Erik M. Jensen, *Taxation and the Constitution: How to Read the Direct Tax Clauses*, 15 J.L. & POL. 687, 704 (1999) ("One of the reasons [the direct tax restriction] worked as a compromise was that it had teeth – it made direct taxes difficult to impose – and it had teeth however slaves were counted").

The Government's view of the clauses is further supported by the near contemporaneous decision of the Supreme Court in *Hylton v. United States*, 3 U.S. (3 Dall.) 171 (1796), holding that a national tax upon carriages was not a direct tax, and thus not subject to apportionment. Justices Chase and Iredell opined that a "direct tax" was one that, unlike the carriage tax, as a practical matter could be apportioned among the States, *id.* at 174 (Chase, J.); *id.* at 181 (Iredell, J.), while Justice Paterson, noting the connection between apportionment and slavery, condemned apportionment as "radically wrong" and "not to be extended by construction," *id.* at 177-78.* As for

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direct taxes lest it drive the Congress back to reliance upon requisitions from the States. *See id.* at 9-10.

* The other Justice to hear the case, Wilson, J., had previously determined while sitting on the Circuit Court of Virginia,

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Murphy's reliance upon *Pollock II*, the Government contends that although it has never been overruled, "every aspect of its reasoning has been eroded," *see, e.g.*, *Stanton v. Baltic Mining Co.*, 240 U.S. 103, 112-13 (1916), and notes that in *Pollock II* itself the Court acknowledged that "taxation on business, privileges, or employments has assumed the guise of an excise tax," 158 U.S. at 635. *Pollock II*, in the Government's view, is therefore too weak a reed to support Murphy's broad definition of "direct tax" and certainly does not make "a tax on the conversion of human capital into money . . . problematic."

Murphy replies that the Government's historical analysis does not respond to the contemporaneous sources she and the amici identified showing that taxes imposed upon individuals are direct taxes. As for *Hylton,* Murphy argues nothing in that decision precludes her position; the Justices viewed the carriage tax there at issue as a tax upon an expense, *see* 3 U.S. (3 Dall.) at 175 (Chase, J.); *see also id.* at 180-81 (Paterson, J.), which she agrees is not a direct tax. *See Pollock II*, 158 U.S. at 626-27. To the extent *Hylton* is inconsistent with her position, however, Murphy contends her references to the Federalist are more authoritative evidence of the Framers' understanding of the term.

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that the tax was not direct and so he did not write a full opinion. *Id.* at 183-84.

Murphy makes no attempt to reconcile her definition with the long line of cases identifying various taxes as excise taxes, although several of them seem to refute her position directly. In particular, we do not see how a known excise, such as the estate tax, *see, e.g., New York Trust Co. v. Eisner*, 256 U.S. 345, 349, (1921); *Knowlton*, 178 U.S. at 81-83, or a tax upon income from employment, *see Pollock II*, 158 U.S. at 635; *Pollock I*, 157 U.S. at 579; *cf. Steward Mach. Co. v. Davis*, 301 U.S. 548, 580-81 (1937) (tax upon employers based upon wages paid to employees is an excise), can be shifted to another person, absent which they seem to be in irreconcilable conflict with her position that a tax that cannot be shifted to someone else is a direct tax. Though it could be argued that the incidence of an estate tax is inevitably shifted to the beneficiaries, we see at work none of the restraint upon excessive taxation that Murphy claims such shifting is supposed to provide; the tax is triggered by an event, death, that cannot be shifted or avoided. In any event, *Knowlton* addressed the argument that *Pollock I* and *II* made ability to shift the hallmark of a direct tax, and rejected it. 178 U.S. at 81-82. Regardless what the original understanding may have been, therefore, we are bound to follow the Supreme Court, which has strongly intimated that Murphy's position is not the law.

That said, neither need we adopt the Government's position that direct taxes are only those capable of satisfying the constraint of apportionment. In the abstract, such a constraint is no constraint at all;

virtually any tax may be apportioned by establishing different rates in different states. *See Pollock II*, 158 U.S. at 632-33. If the Government's position is instead that by "capable of apportionment" it means "capable of apportionment in a manner that does not unfairly tax some individuals more than others," then it is difficult to see how a land tax, which is widely understood to be a direct tax, could be apportioned by population without similarly imposing significantly non-uniform rates. *See Hylton*, 3 U.S. (3 Dall.) at 178-79 (Paterson, J.); Johnson, *Constitutional Absurdity, supra,* at 328. *But see, e.g., Hylton*, 3 U.S. (3 Dall.) at 183 (Iredell, J.) (contending land tax is capable of apportionment).

We find it more appropriate to analyze this case based upon the precedents and therefore to ask whether the tax laid upon Murphy's award is more akin, on the one hand, to a capitation or a tax upon one's ownership of property, or, on the other hand, more like a tax upon a use of property, a privilege, an activity, or a transaction, *see Thomas*, 192 U.S. at 370. Even if we assume one's human capital should be treated as personal property, it does not appear that this tax is upon ownership; rather, as the Government points out, Murphy is taxed only after she receives a compensatory award, which makes the tax seem to be laid upon a transaction. *See Tyler v. United States*, 281 U.S. 497, 502 (1930) ("A tax laid upon the happening of an event, as distinguished from its tangible fruits, is an indirect tax which Congress, in respect of some events . . . undoubtedly

may impose"); *Simmons v. United States*, 308 F.2d 160, 166 (4th Cir. 1962) (tax upon receipt of money is not a direct tax); *cf. Penn Mut.*, 277 F.2d at 20. Murphy's situation seems akin to an involuntary conversion of assets; she was forced to surrender some part of her mental health and reputation in return for monetary damages. *Cf.* 26 U.S.C. § 1033 (property involuntarily converted into money is taxed to extent of gain recognized).

At oral argument Murphy resisted this formulation on the ground that the receipt of an award in lieu of lost mental health or reputation is not a transaction. This view is tenable, however, only if one decouples Murphy's injury (emotional distress and lost reputation) from her monetary award, but that is not beneficial to Murphy's cause, for then Murphy has nothing to offset the obvious accession to her wealth, which is taxable as income. Murphy also suggested at oral argument that there was no transaction because she did not profit. Whether she profited is irrelevant, however, to whether a tax upon an award of damages is a direct tax requiring apportionment; profit is relevant only to whether, if it is a direct tax, it nevertheless need not be apportioned because the object of the tax is income within the meaning of the Sixteenth Amendment. *Cf. Spreckels*, 192 U.S. at 412-13 (tax upon gross receipts associated with business of refining sugar not a direct tax); *Penn Mut.*, 277 F.2d at 20 (tax upon gross receipts deemed valid indirect tax despite taxpayer's net loss).

So we return to the question: Is a tax upon this particular kind of transaction equivalent to a tax upon a person or his property? *Cf. Bromley*, 280 U.S. at 138 (assuming without deciding that a tax "levied upon all the uses to which property may be put, or upon the exercise of a single power indispensable to the enjoyment of all others over it, would be in effect a tax upon property"). Murphy did not receive her damages pursuant to a business activity, *cf. Flint*, 220 U.S. at 151; *Spreckels*, 192 U.S. at 411, and we therefore do not view this tax as an excise under that theory. *See Stratton's Independence, Ltd. v. Howbert*, 231 U.S. 399, 414-15 (1913) ("The sale outright of a mining property might be fairly described as a mere conversion of the capital from land into money"). On the other hand, as noted above, the Supreme Court several times has held a tax not related to business activity is nonetheless an excise. And the tax at issue here is similar to those.

Bromley, in which a gift tax was deemed an excise, is particularly instructive: The Court noted it was "a tax laid only upon the exercise of a single one of those powers incident to ownership," 280 U.S. at 136, which distinguished it from "a tax which falls upon the owner merely because he is owner, regardless of the use or disposition made of his property," *id.* at 137. A gift is the functional equivalent of a below-market sale; it therefore stands to reason that if, as *Bromley* holds, a gift tax, or a tax upon a below-market sale, is a tax laid not upon ownership but upon the exercise of a power "incident to ownership,"

then a tax upon the sale of property at fair market value is similarly laid upon an incidental power and not upon ownership, and hence is an excise. Therefore, even if we were to accept Murphy's argument that the human capital concept is reflected in the Sixteenth Amendment, a tax upon the involuntary conversion of that capital would still be an excise and not subject to the requirement of apportionment. *But see Nicol,* 173 U.S. at 521 (indicating pre-*Bromley* that tax upon "every sale made in any place . . . is really and practically upon property").

In any event, even if a tax upon the sale of property is a direct tax upon the property itself, we do not believe Murphy's situation involves a tax "upon the sale itself, considered separate and apart from the place and the circumstances of the sale." *Id.* at 520. Instead, as in *Nicol*, this tax is more akin to "a duty upon the facilities made use of and actually employed in the transaction." *Id.* at 519. To be sure, the facility used in *Nicol* was a commodities exchange whereas the facility used by Murphy was the legal system, but that hardly seems a significant distinction. The tax may be laid upon the proceeds received when one vindicates a statutory right, but the right is nonetheless a "creature of law," which *Knowlton* identifies as a "privilege" taxable by excise. 178 U.S. at 55 (right to take property by inheritance is granted by law and therefore taxable as upon a privilege);* *cf. Steward*,

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* For the same reason, we infer from *Knowlton* that a tax laid upon an amount received in settlement of a suit for a

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301 U.S. at 580-81 ("[N]atural rights, so called, are as much subject to taxation as rights of less importance. An excise is not limited to vocations or activities that may be prohibited altogether. . . . It extends to vocations or activities pursued as of common right.") (footnote omitted).

2. Uniformity

The Congress may not implement an excise tax that is not "uniform throughout the United States." U.S. CONST. art. I, § 8, cl. 1. A "tax is uniform when it operates with the same force and effect in every place where the subject of it is found." *United States v. Ptasynski*, 462 U.S. 74, 82 (1983) (internal quotation marks omitted); *see also Knowlton*, 178 U.S. at 84-86. The tax laid upon an award of damages for a nonphysical personal injury operates with "the same force and effect" throughout the United States and therefore satisfies the requirement of uniformity.

III. Conclusion

For the foregoing reasons, we conclude (1) Murphy's compensatory award was not received on account of personal physical injuries, and therefore is not exempt from taxation pursuant to § 104(a)(2) of the IRC; (2) the award is part of her "gross income,"

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personal nonphysical injury would also be an excise. *See* 178 U.S. at 55.

as defined by § 61 of the IRC; and (3) the tax upon the award is an excise and not a direct tax subject to the apportionment requirement of Article I, Section 9 of the Constitution. The tax is uniform throughout the United States and therefore passes constitutional muster. The judgment of the district court is accordingly

Affirmed.

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

Argued February 24, 2006 Decided August 22, 2006

No. 05-5139

MARRITA MURPHY AND
DANIEL J. LEVEILLE,
APPELLANTS

v.

INTERNAL REVENUE SERVICE AND
UNITED STATES OF AMERICA,
APPELLEES

Appeal from the United States District Court
for the District of Columbia
(No. 03cv02414)

David K. Colapinto argued the cause for appellants. With him on the briefs was Stephen M. Kohn.

Colin M. Dunham was on the brief for amicus curiae No Fear Coalition in support of appellant.

John A. Nolet, Attorney, U.S. Department of Justice, argued the cause for appellees. With him on the brief were Kenneth L. Wainstein, U.S. Attorney, and Kenneth L. Greene, Attorney. Bridget M. Rowan, Attorney, entered an appearance.

Before: GINSBURG, *Chief Judge*, and ROGERS and BROWN, *Circuit Judges*.

Opinion for the Court filed by Chief Judge GINSBURG.

GINSBURG, *Chief Judge*. Marrita Murphy brought this suit to recover income taxes she paid on the compensatory damages for emotional distress and loss of reputation she was awarded in an administrative action she brought against her former employer. Murphy contends that under § 104(a)(2) of the Internal Revenue Code (IRC), 26 U.S.C. § 104(a)(2), her award should have been excluded from her gross income because it was compensation received "on account of personal physical injuries or physical sickness." In the alternative, she maintains § 104(a)(2) is unconstitutional insofar as it fails to exclude from gross income revenue that is not "income" within the meaning of the Sixteenth Amendment to the Constitution of the United States.

We hold, first, that Murphy's compensation was not "received . . . on account of personal physical injuries" excludable from gross income under § 104(a)(2). We agree with the taxpayer, however, that § 104(a)(2) is unconstitutional as applied to her award because compensation for a non-physical personal injury is not income under the Sixteenth Amendment if, as here, it is unrelated to lost wages or earnings.

I. Background

In 1994 Marrita Leveille (now Murphy) filed a complaint with the Department of Labor alleging that her former employer, the New York Air National Guard (NYANG), in violation of various whistleblower statutes, had "blacklisted" her and provided unfavorable references to potential employers after she had complained to state authorities of environmental hazards on a NYANG airbase. The Secretary of Labor determined the NYANG had unlawfully discriminated and retaliated against Murphy, ordered that any adverse employment references to the taxpayer in Office of Personnel Management files be withdrawn, and remanded her case to an Administrative Law Judge "for findings on compensatory damages."

On remand Murphy submitted evidence that she had suffered both mental and physical injuries as a result of the NYANG's blacklisting her. A physician testified Murphy had sustained "somatic" and "emotional" injuries. One such injury was "bruxism," or teeth grinding often associated with stress, which may cause permanent tooth damage. Upon finding Murphy had also suffered from other "physical manifestations of stress" including "anxiety attacks, shortness of breath, and dizziness," the ALJ recommended compensatory damages totaling $70,000, of which $45,000 was for "emotional distress or mental anguish," and $25,000 was for "injury to professional reputation" from having been blacklisted. None of the

award was for lost wages or diminished earning capacity.

In 1999 the Department of Labor Administrative Review Board affirmed the ALJ's findings and recommendations. *See Leveille v. N.Y. Air Nat'l Guard,* 1999 WL 966951, at *2-*4 (Oct. 25, 1999). On her tax return for 2000, Murphy included the $70,000 award in her "gross income" pursuant to § 61 of the IRC. *See* 26 U.S.C. § 61(a) ("[G]ross income means all income from whatever source derived"). As a result, she paid $20,665 in taxes on the award.

Murphy later filed an amended return in which she sought a refund of the $20,665 based upon § 104(a)(2) of the IRC, which provides that "gross income does not include . . . damages . . . received . . . on account of personal physical injuries or physical sickness." In support of her amended return, Murphy submitted copies of her dental and medical records. Upon deciding Murphy had failed to demonstrate the compensatory damages were attributable to "physical injury" or "physical sickness," the Internal Revenue Service denied her request for a refund. Murphy thereafter sued the IRS and the United States in the district court.

In her complaint Murphy sought a refund of the $20,665, plus applicable interest, pursuant to the Sixteenth Amendment, along with declaratory and injunctive relief against the IRS pursuant to the Administrative Procedure Act and the Due Process Clause of the Fifth Amendment to the Constitution of

the United States. She argued her compensatory award was in fact for "physical personal injuries" and therefore excluded from gross income under § 104(a)(2). In the alternative Murphy asserted § 104(a)(2) as applied to her award was unconstitutional because the award was not "income" within the meaning of the Sixteenth Amendment. The Government moved to dismiss Murphy's suit as to the IRS, contending the Service was not a proper defendant, and for summary judgment on all claims.

The district court denied the Government's motion to dismiss, holding that Murphy had the right to bring an "action[] for declaratory judgments or . . . [a] mandatory injunction" against an "agency by its official title," pursuant to § 703 of the APA, 5 U.S.C. § 703. *Murphy v. IRS,* 362 F. Supp. 2d 206, 211-12, 218 (2005). The court then rejected all Murphy's claims on the merits and granted summary judgment for the Government and the IRS. *Id.* at 218. Murphy now appeals the judgment of the district court with respect to her claims under § 104(a)(2) and the Sixteenth Amendment.

II. Analysis

We review the district court's grant of summary judgment *de novo, Flynn v. R.C. Tile,* 353 F.3d 953, 957 (2004), bearing in mind that summary judgment is appropriate only "if there is no genuine issue as to any material fact and if the moving party is entitled to judgment as a matter of law," *Anderson v. Liberty*

Lobby, Inc., 477 U.S. 242, 250 (1986). Before addressing Murphy's claims on their merits, however, we must determine whether the district court erred in holding the IRS was a proper defendant.

A. The IRS as a Defendant

The Government contends the courts lack jurisdiction over Murphy's claims against the IRS because the Congress has not waived that agency's immunity from declaratory and injunction actions pursuant to 28 U.S.C. § 2201(a) (Courts may grant declaratory relief "except with respect to Federal taxes") and 26 U.S.C. § 7421(a) ("no suit for the purpose of restraining the assessment or collection of any tax shall be maintained in any court by any person"); and insofar as the Government has waived immunity for civil actions seeking tax refunds under 28 U.S.C § 1346(a)(1), that provision on its face applies to "civil action[s] against the United States," not against the IRS. In reply Murphy argues only that the Government forfeited the issue of sovereign immunity because it did not cross-appeal the district court's denial of its motion to dismiss. *See* Fed. R. App. P. 4(a)(3). Notwithstanding the Government's failure to cross-appeal, however, the court must address a question concerning its jurisdiction. *See Occidental Petroleum Corp. v. SEC*, 873 F.2d 325, 328 (D.C. Cir. 1989) ("As a preliminary matter . . . we must address the question of our jurisdiction to hear this appeal").

Murphy and the district court are correct that § 703 of the APA does create a right of action for equitable relief against a federal agency but, as the Government correctly points out, the Congress has preserved the immunity of the United States from declaratory and injunctive relief with respect to all tax controversies except those pertaining to the classification of organizations under § 501(c) of the IRC. *See* 28 U.S.C. § 2201(a); 26 U.S.C. § 7421(a). As an agency of the Government, of course, the IRS shares in that immunity. *See Settles v. U.S. Parole Comm'n,* 429 F.3d 1098, 1106 (D.C. Cir. 2005) (agency "retains the immunity it is due as an arm of the federal sovereign"). Insofar as the Congress has waived sovereign immunity with respect to suits for tax refunds under 28 U.S.C. § 1346(a)(1), that provision specifically contemplates only actions against the "United States." Therefore, we hold the IRS, unlike the United States, may not be sued *eo nomine* in this case.

B. Section 104(a)(2) of the IRC

Section 104(a) ("Compensation for injuries or sickness") provides that "gross income [under § 61 of the IRC] does not include the amount of any damages (other than punitive damages) received . . . on account of personal physical injuries or physical sickness." 26 U.S.C. § 104(a)(2). Since 1996 it has further provided that, for purposes of this exclusion, "emotional distress shall not be treated as a physical injury or physical sickness." *Id.* § 104(a). The version

of § 104(a)(2) in effect prior to 1996 had excluded from gross income monies received in compensation for "personal injuries or sickness," which included both physical and nonphysical injuries such as emotional distress. *Id.* § 104(a)(2) (1995); *see United States v. Burke,* 504 U.S. 229, 235 n.6 (1992) ("§ 104(a)(2) in fact encompasses a broad range of physical and nonphysical injuries to personal interests"). In *Commissioner v. Schleier,* 515 U.S. 323 (1995), the Supreme Court held that before a taxpayer may exclude compensatory damages from gross income pursuant to § 104(a)(2), he must first demonstrate that "the underlying cause of action giving rise to the recovery [was] 'based upon tort or tort type rights.'" *Id.* at 337. The taxpayer has the same burden under the statute as amended. *See, e.g., Chamberlain v. United States,* 401 F.3d 335, 341 (5th Cir. 2005).

Murphy contends § 104(a)(2), even as amended, excludes her particular award from gross income. First, she asserts her award was "based upon . . . tort type rights" in the whistle-blower statutes the NYANG violated – a position the Government does not challenge. Second, she claims she was compensated for "physical" injuries, which claim the Government does dispute.

Murphy points both to her physician's testimony that she had experienced "somatic" and "body" injuries "as a result of NYANG's blacklisting [her]," and to the *American Heritage Dictionary,* which defines "somatic" as "relating to, or affecting the body, especially as distinguished from a body part, the mind, or

the environment." Murphy further argues the dental records she submitted to the IRS proved she has suffered permanent damage to her teeth. Citing *Walters v. Mintec/International,* 758 F.2d 73, 78 (3d Cir. 1985), and *Payne v. General Motors Corp.,* 731 F. Supp. 1465, 1474-75 (D. Kan. 1990), Murphy contends that "substantial physical problems caused by emotional distress are considered physical injuries or physical sickness."

Murphy further contends that neither § 104 of the IRC nor the regulation issued thereunder "limits the physical disability exclusion to a physical stimulus." In fact, as Murphy points out, the applicable regulation, which provides that § 104(a)(2) "excludes from gross income the amount of any damages received (whether by suit or agreement) on account of personal injuries or sickness," 26 C.F.R. § 1.104-1(c), does not distinguish between physical injuries stemming from physical stimuli and those arising from emotional trauma; rather, it tracks the pre-1996 text of § 104(a)(2), which the IRS agrees excluded from gross income compensation both for physical and for nonphysical injuries.

For its part, the Government argues Murphy's exclusive focus upon the word "physical" in § 104(a)(2) is misplaced; more important is the phrase "on account of." In *O'Gilvie v. United States,* 519 U.S. 79 (1996), the Supreme Court read that phrase to require a "strong [] causal connection," thereby making § 104(a)(2) "applicable only to those personal injury lawsuit damages that were awarded by reason of, or

because of, the personal injuries." *Id.* at 83. The Court specifically rejected a "but-for" formulation in favor of a "stronger causal connection." *Id.* at 82-83. The Government therefore concludes Murphy must demonstrate she was awarded damages "because of" her physical injuries, which the Government claims she has failed to do.

Indeed, as the Government points out, the ALJ expressly recommended, and the Board expressly awarded, compensatory damages "because of" Murphy's nonphysical injuries. The Board analyzed the ALJ's recommendation under the headings "Compensatory damage for emotional distress or mental anguish" and "Compensatory damage award for injury to professional reputation." In describing the ALJ's proposed award as "reasonable," the Board stated Murphy was to receive "$45,000 for mental pain and anguish" and "$25,000 for injury to professional reputation." That Murphy suffered from bruxism or other physical symptoms of stress is of no moment, the Government argues, because "the Board awarded her damages, not to compensate [her for that] particular injur[y], but explicitly with respect to nonphysical injuries."

In reply Murphy merely reiterates that she suffered "physical" injuries. She does not address the Government's point that she received her award "on account of" her mental distress and reputational loss, not her bruxism or other physical symptoms.

Murphy's failure to address the Government's position is telling. Although the pre-1996 version of § 104(a)(2) was at issue in *O'Gilvie,* the Court's analysis of the phrase "on account of," which phrase was unchanged by the 1996 Amendments, remains controlling here. Murphy no doubt suffered from certain physical manifestations of emotional distress, but the record clearly indicates the Board awarded her compensation only "for mental pain and anguish" and "for injury to professional reputation." *Leveille,* 1999 WL 966951, at *5. The Board thus having left no room for doubt about the grounds for her award, we conclude Murphy's damages were not "awarded by reason of, or because of, . . . [physical] personal injuries," *O'Gilvie,* 519 U.S. at 83. Therefore, § 104(a)(2) does not permit Murphy to exclude her award from gross income.* But is that constitutional?

C. The Sixteenth Amendment

The Government of the United States is a government of limited powers: "Every law enacted by Congress must be based on one or more of its powers enumerated in the Constitution." *United States v. Morrison,* 529 U.S. 598, 607 (2000). The constitutional

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* Insofar as compensation for nonphysical personal injuries appears to be excludable from gross income under 26 C.F.R. § 1.104-1, the regulation conflicts with the plain text of § 104(a)(2); in these circumstances the statute clearly controls. *See Brown v. Gardner,* 513 U.S. 115, 122 (1994) (finding "no antidote to [a regulation's] clear inconsistency with a statute").

power of the Congress to tax income is provided in the Sixteenth Amendment, ratified in 1913:

> The Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration.

The Supreme Court has held the word "incomes" in the Amendment and the phrase "gross income" in § 61(a) of the IRC are coextensive. *See Helvering v. Clifford,* 309 U.S. 331, 334 (1940) (§ 61 represents the "full measure of [the Congress's] taxing power"). When it first construed those terms in *Eisner v. Macomber,* 252 U.S. 189, 207 (1920), the Supreme Court held the taxing power extended to any "gain derived from capital, from labor, or from both combined." Later, after explaining that *Eisner* was not "meant to provide a touchstone to all future gross income questions," the Court added that under the IRC – and, by implication, under the Sixteenth Amendment – the Congress may "tax all gains" or "accessions to wealth." *Commissioner v. Glenshaw Glass Co.,* 348 U.S. 426, 430-31 (1955).

Murphy argues that, being neither a gain nor an accession to wealth, her award is not income and § 104(a)(2) is therefore unconstitutional insofar as it would make the award taxable as income. Broad though the power granted in the Sixteenth Amendment is, the Supreme Court, as Murphy points out, has long recognized "the principle that a restoration of capital [i]s not income; hence it [falls] outside the

definition of 'income' upon which the law impose[s] a tax." *O'Gilvie,* 519 U.S. at 84; *see, e.g., Doyle v. Mitchell Bros. Co.,* 247 U.S. 179, 187-88 (1918); *S. Pac. Co. v. Lowe,* 247 U.S. 330, 335 (1918) (return of capital not income under IRC or Sixteenth Amendment). By analogy, Murphy contends a damage award for personal injuries – including nonphysical injuries – is not income but simply a return of capital – "human capital," as it were. *See* Gary S. Becker, *Human Capital* (1st ed.1964); Gary S. Becker, "The Economic Way of Looking at Life," 43-45 (Nobel Lecture, Dec. 9, 1992).

According to Murphy, the Supreme Court read the concept of "human capital" into the IRC in *Glenshaw Glass.* There, in holding that punitive damages for personal injury were "gross income" under the predecessor to § 61, the Court stated:

> The long history of . . . holding personal injury recoveries nontaxable on the theory that they roughly correspond to a return of capital cannot support exemption of punitive damages following injury to property. . . . Damages for personal injury are by definition compensatory only. Punitive damages, on the other hand, cannot be considered a restoration of capital for taxation purposes.

348 U.S. at 432 n.8. In Murphy's view, the Court thereby made clear that the recovery of compensatory damages for a "personal injury" – of whatever type – is analogous to a "return of capital" and therefore is

not income under the IRC or the Sixteenth Amendment.

In support of her reading of the caselaw, Murphy contends the IRC, as drafted shortly after "passage of the [Sixteenth] Amendment demonstrates that compensatory damages designed to make a person whole are excluded from the definition of 'income.'" She focuses upon the three sources the Supreme Court quoted in *O'Gilvie,* 519 U.S. at 84-87, to wit, an Opinion of the Attorney General, a Decision of the Department of the Treasury, and a Report issued by the Ways and Means Committee of the House of Representatives – each of which predates the first version of § 104(a)(2), namely, § 213(b)(6) of the Revenue Act of 1918. *See* 40 Stat. 1057, 1066 (1919).

In an opinion rendered to the Secretary of the Treasury on the question whether proceeds from an accident insurance policy were income under the IRC as it stood prior to the 1918 Act, the Attorney General stated:

> Without affirming that the human body is in a technical sense the "capital" invested in an accident policy, in a broad, natural sense the proceeds of the policy do but substitute, so far as they go, capital which is the source of future periodical income. They merely take the place of capital in human ability which was destroyed by the accident. They are therefore "capital" as distinguished from "income" receipts.

31 Op. Att'y. Gen. 304, 308 (1918). In a revenue ruling, the Department of the Treasury then reasoned that

> upon similar principles . . . an amount received by an individual as the result of a suit or compromise for personal injuries sustained . . . through accident is not income [that is] taxable.

T.D. 2747, 20 Treas. Dec. Int. Rev. 457 (1918).

As for the House Report on the bill that became the Revenue Act of 1918, it states:

> Under the present law it is doubtful whether amounts received through accident or health insurance, or under workmen's compensation acts, as compensation for personal injury or sickness, and damages received on account of such injuries or sickness, are required to be included in gross income.

H.R.Rep. No. 65-767, at 9-10 (1918). Thereafter, the Congress passed the Act, § 213(b)(6) of which excluded from gross income "[a]mounts received, through accident or health insurance or under workman's compensation acts, as compensation for personal injuries or sickness, plus the amount of any damages received whether by suit or agreement on account of such injuries or sickness." 40 Stat. 1057, 1066 (1919).

Because the 1918 Act followed soon after ratification of the Sixteenth Amendment, Murphy contends that the statute reflects the meaning of the Amendment as

it would have been understood by those who framed, adopted, and ratified it. She observes that in *Dotson v. United States,* 87 F.3d 682 (5th Cir. 1996), the court concluded upon the basis of the House Report that the "Congress first enacted the personal injury compensation exclusion . . . when such payments were considered the return of human capital, and thus not constitutionally taxable 'income' under the 16th amendment." *Id.* at 685.

The Government attacks Murphy's constitutional argument on all fronts. First, invoking the presumption that the Congress enacts laws within its constitutional limits, *see Rust v. Sullivan,* 500 U.S. 173, 191 (1991), the Government asserts at the outset that § 104(a)(2) is constitutional even if, as amended in 1996, it does permit the taxation of compensatory damages. Indeed, the Government goes further, contending the Congress could, consistent with the Sixteenth Amendment, repeal § 104(a)(2) altogether and tax compensation even for physical injuries.

Noting that the power of the Congress to tax income "extends broadly to all economic gains," *Commissioner v. Banks,* 543 U.S. 426, 433 (2005), the Government next maintains that compensatory damages "plainly constitute economic gain, for the taxpayer unquestionably has more money after receiving the damages than she had prior to receipt of the award." On that basis, the Government contends Murphy's reliance upon footnote eight of *Glenshaw Glass* is misplaced; merely because the Congress "has historically excluded personal injury recoveries from

gross income, based on the make-whole or restoration-of-human-capital theory, does not mean that such an exclusion is mandated by the Sixteenth Amendment." Because the Supreme Court in *Glenshaw Glass* was construing "gross income" with reference only to the IRC, the Government argues footnote eight addresses only a now abandoned congressional policy, not the outer limit of the Sixteenth Amendment.

According to the Government, the same is true of the 1918 Act and the interpretive rulings that preceded it. Although the Government acknowledges that the dictum in *Dotson,* 87 F.3d at 685, accords with Murphy's position, the Government notes the court there relied solely upon the House Report. Because the House Report merely states "it is doubtful whether . . . compensation for personal injury or sickness . . . [is] required to be included in gross income," H.R. Rep. No. 65-767, at 9-10 (1918), the Government observes that the "report simply does not establish that Congress believed taxing compensatory personal injury damages would be unconstitutional."

In addition, the Government challenges the coherence of Murphy's analogy between a return of "human capital or well-being" and a return of "financial capital," the latter of which it acknowledges does not constitute income under the Sixteenth Amendment. *See Doyle,* 247 U.S. at 187; *S. Pac. Co.,* 247 U.S. at 335. The Government first observes that financial capital, like all property, has a "basis," defined by the IRC as "the cost of such property," 26

U.S.C. § 1012, adjusted "for expenditures, receipts, losses, or other items, properly chargeable to [a] capital account," *id.* § 1016(a)(1); thus, when a taxpayer sells property, his income is "the excess of the amount realized therefrom over the adjusted basis." *Id.* § 1001(a). The Government then observes that "[b]ecause people do not pay cash or its equivalent to acquire their well-being, they have no basis in it for purposes of measuring a gain (or loss) upon the realization of compensatory damages." Nor is there any corresponding theory of "human depreciation," which would permit "an offsetting deduction for the exhaustion of the taxpayer's physical prowess and mental agility." Boris I. Bittker & Lawrence Lokken, *Federal Taxation of Income, Estates, and Gifts* ¶ 5.6 (2003). Finally, the Government points to the Ninth Circuit's dictum in *Roemer v. Commissioner,* 716 F.2d 693 (1983), suggesting that "[s]ince there is no tax basis in a person's health and other personal interests, money received as compensation for an injury to those interests might be considered a realized accession to wealth." *Id.* at 696 n.2.

At the outset, we reject the Government's breathtakingly expansive claim of congressional power under the Sixteenth Amendment – upon which it founds the more far-reaching arguments it advances here. The Sixteenth Amendment simply does not authorize the Congress to tax as "incomes" every sort of revenue a taxpayer may receive. As the Supreme Court noted long ago, the "Congress cannot make a thing income which is not so in fact." *Burk-Waggoner*

Oil Ass'n v. Hopkins, 269 U.S. 110, 114 (1925). Indeed, because the "the power to tax involves the power to destroy," *McCulloch v. Maryland,* 17 U.S. (4 Wheat.) 316, 431 (1819), it would not be consistent with our constitutional government, and the sanctity of property in our system, merely to rely upon the legislature to decide what constitutes income.

Fortunately, we need not rely solely upon the wisdom and beneficence of the Congress for, when the Sixteenth Amendment was drafted, the word "incomes" had well understood limits. To be sure, the Supreme Court has broadly construed the phrase "gross income" in the IRC and, by implication, the word "incomes" in the Sixteenth Amendment, but it also has made plain that the power to tax income extends only to "gain[s]" or "accessions to wealth." *Glenshaw Glass,* 348 U.S. at 430-31. That is why, as noted above, the Supreme Court has held a "return of capital" is not income. *Doyle,* 247 U.S. at 187; *S. Pac. Co.,* 247 U.S. at 335. The question in this case is not, however, about a return of capital – except insofar as Murphy analogizes human capital to physical or financial capital; the question is whether the compensation she received for her injuries is income.*

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* In any event, the Government's quarrel with Murphy's analogy, based upon *Glenshaw Glass,* of "human capital" to financial or physical capital is not persuasive. To be sure, the analogy is incomplete; personal injuries do not entail an adjustment to any basis, nor are human resources, such as reputation, depreciable for tax purposes. But nothing in Murphy's argument

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To determine whether Murphy's compensation is income under the Sixteenth Amendment, we are instructed by the Supreme Court first to consider whether the taxpayer's award of compensatory damages is "a substitute for [a] normally untaxed personal . . . quality, good, or 'asset.'" *O'Gilvie,* 519 U.S. at 86. Accordingly, we join our sister circuits by asking: "In lieu of what were the damages awarded"? *Raytheon Prod. Corp. v. Commissioner,* 144 F.2d 110, 113 (1st Cir. 1944); *see Francisco v. United States,* 267 F.3d 303, 319 (3d Cir. 2001) (treating *Raytheon*'s "in lieu of" test as authoritative); *Tribune Publ'g Co. v. United States,* 836 F.2d 1176, 1178 (9th Cir. 1988) (applying "in lieu of" test to determine whether settlement proceeds were income); *Gilbertz v. United States,* 808 F.2d 1374, 1378 (10th Cir. 1987) (adopting "in lieu of" test to determine whether compensatory damages were income). Here, if the $70,000 Murphy received was "in lieu of" something "normally untaxed," *O'Gilvie,* 519 U.S. at 86, then her compensation is not income under the Sixteenth Amendment; it is neither a "gain" nor an "accession[] to wealth." *Glenshaw Glass,* 348 U.S. at 430-31.

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implies a need to account for the basis in or to depreciate anything. Her point, rather, is that as with compensation for a harm to one's financial or physical capital, the payment of compensation for the diminution of a personal attribute, such as reputation, is but a restoration of the status quo ante, analogous to a "restoration of capital," *Glenshaw Glass,* 348 U.S. at 432 n.8; in neither context does the payment result in a "gain" or "accession[] to wealth," *id.* at 430-31.

As we have seen, it is clear from the record that the damages were awarded to make Murphy emotionally and reputationally "whole" and not to compensate her for lost wages or taxable earnings of any kind. The emotional well-being and good reputation she enjoyed before they were diminished by her former employer were not taxable as income. Under this analysis, therefore, the compensation she received in lieu of what she lost cannot be considered income and, hence, it would appear the Sixteenth Amendment does not empower the Congress to tax her award.

Our conclusion at this point is tentative because the Supreme Court has also instructed that, in defining "incomes," we should rely upon "the commonly understood meaning of the term which must have been in the minds of the people when they adopted the Sixteenth Amendment." *Merchants' Loan & Trust Co. v. Smietanka,* 255 U.S. 509, 519 (1921). And, to discern the original understanding of a provision of the Constitution, we must examine any contemporaneous implementing legislation. *See Myers v. United States,* 272 U.S. 52, 175 (1926) ("This court has repeatedly laid down the principle that a contemporaneous legislative exposition of the Constitution . . . , acquiesced in for a long term of years, fixes the construction to be given its provisions"); *see Macomber,* 252 U.S. at 202 (district judge correctly treated "construction of the [Revenue Act of 1913] as inseparable from the interpretation of the Sixteenth Amendment"). Therefore, we must inquire whether

"the people when they adopted the Sixteenth Amendment," or the Congress when it implemented the Amendment, would have understood compensatory damages for a nonphysical injury to be "income."

In the years immediately following ratification of the Sixteenth Amendment, the Congress created and then thrice revised the IRC. *See* Revenue Act of 1913, ch. 16, 38 Stat. 114 (1913); Revenue Act of 1916, ch. 463, 39 Stat. 756 (1916); Revenue Act of 1917, ch. 63, 40 Stat. 300 (1917); Revenue Act of 1918, ch. 18, 40 Stat. 1057 (1919). Of the four enactments, that of 1918 was the first to address the tax treatment of compensatory damages for personal injuries, and it did so without distinguishing between physical and nonphysical injuries. We agree with the Government that the House Report on the 1918 Act is ambiguous and therefore unhelpful on the question before us. We concur in Murphy's view, however, that the Attorney General's 1918 opinion and the Treasury Department's ruling of the same year strongly suggest that the term "incomes" as used in the Sixteenth Amendment does not extend to monies received solely in compensation for a personal injury and unrelated to lost wages or earnings.

That emotional distress and loss of reputation were both actionable in tort when the Sixteenth Amendment was adopted supports the view that compensation for these nonphysical injuries was not regarded differently than was compensation for physical injuries and, therefore, was not considered income by the framers of the Amendment and the

state legislatures that ratified it. By 1913, in at least 39 of the then-48 states and in the District of Columbia, the law made compensatory damages for "mental suffering" recoverable in the same matter as compensatory damages for physical harms; indeed, in 34 of those states, there are reported cases involving defamation and other reputational injuries* – the

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* *See, e.g., Garrison v. Sun Printing & Publ'g Ass'n,* 207 N.Y. 1, 6, 100 N.E. 430, 431 (1912) (plaintiffs are "entitled to recover compensatory damages for mental distress resulting from the publication of defamatory words actionable in themselves"); *Guisti v. Galveston Tribune,* 105 Tex. 497, 504-05 150 S.W. 874, 877 (1912) (holding statute afforded "right to maintain an action for a publication not libelous per se [without having] to allege or prove special damages . . . for mental anguish"); *Fields v. Bynum,* 72 S.E. 449, 451 (1911) (general damages in defamation actions "include injury to the feelings, and mental suffering endured in consequence"); *Comer v. Advertiser Co.,* 172 Ala. 613, 55 So. 195, 198 (1911) (in libel actions "damages for mental pain and suffering . . . must in all cases be fixed by the jury, in view of all the facts and circumstances surrounding any particular case"); *Miller v. Dorsey,* 149 Mo. App. 24, 129 S.W. 66, 69 (1910) (upholding jury award of damages in action for slander "to compensate [plaintiff] for the mortification and shame he might have suffered, and the disgrace and dishonor attempted to be cast upon him, and all damages done to his reputation"); *Jozsa v. Moroney,* 125 La. 813, 821, 51 So. 908, 911 (1910) (in libel action "damages for mental suffering alone can be recovered, although the party may have suffered no other loss"); *Moore v. Maxey,* 152 Ill. App. 647, 1910 WL 1686, at *2 (1910) ("Where words spoken are actionable *per se* . . . there need be no direct evidence of mental suffering to enable the jury to consider it in their estimate of damages"); *Davis v. Mohn,* 145 Iowa 417, 124 N.W. 206, 207 (1910) (holding mental "pain and suffering may be considered by the jury in determining the amount of damages in cases where the words spoken are actionable [as slander] per se"); *Henry v. Cherry & Webb,* 30 R.I. 13, 73 A. 97, 102 (1909)

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(noting that "mental suffering alone [will] sustain a right of action" if "the words spoken or pictures published are of such a nature that the court can conclude, as a matter of law, that they will tend to degrade the person, or hold him up to public hatred, contempt, or ridicule, or cause him to be shunned and avoided"); *Neafie v. Hoboken Printing & Publ'g Co.*, 75 N.J.L. 564, 566, 68 A. 146, 147 (1907) (rejecting view that "mental anguish cannot be considered in estimating compensatory damages in an action of libel"); *McArthur v. Sault News Printing Co.*, 148 Mich. 556, 558, 112 N.W. 126, 127 (1907) ("A woman might have a bad reputation and a bad character, neither of which would be changed by such a [libelous] publication, and yet be entitled to substantial damages for injuries to her feelings resulting from the publication"); *Todd v. Every Evening Printing Co.*, 22 Del. 233, 66 A. 97, 99 (1907) ("amount to be awarded to the plaintiff should be such as would reasonably compensate him for any wrong done to his reputation, good name, or fame, and for any mental suffering caused thereby as shown by the evidence"); *Gendron v. St. Pierre*, 73 N.H. 419, 62 A. 966, 969 (1905) ("amount of the damages" in slander action "depends in part upon the effect of the malice upon the plaintiff's mind"); *Ott v. Press Pub. Co.*, 40 Wash. 308, 310, 82 P. 403, 404 (1905) ("upon a proper showing damages for mental pain and suffering may be recovered" in libel action); *Wash. Times Co. v. Downey*, 26 App. D.C. 258, 1905 WL 17653, at *4 (1905) (holding "plaintiff is . . . entitled to recover as general damages for injury to her feelings and the mental suffering which she endured as a natural result of the [libelous] publication"); *Hanson v. Krehbiel*, 68 Kan. 670, 75 P. 1041, 1042 (1904) (noting that general damages for libel and slander actions are "designed to compensate for that large and substantial class of injuries arising from injured feelings, mental suffering and anguish, and personal and public humiliation"); *Finger v. Pollack*, 188 Mass. 208, 209, 74 N.E. 317, 318 (1905) ("In an action for slander one of the elements of damage is mental suffering"); *Davis v. Starrett*, 97 Me. 568, 55 A. 516, 519 (1903) ("plaintiff is entitled to recover compensation [for] slander, such as injury to the feelings and injury to the reputation"); *Bedtkey v. Bedtkey*, 15 S.D. 310, 89 N.W. 479, 480 (1902) (holding "evidence of injury to feelings having been admitted

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without objection, damages therefore are recoverable"); *Kidder v. Bacon,* 74 Vt. 263, 52 A. 322, 324 (1902) ("It is well settled that when the words spoken are actionable the jury have a right to consider the mental suffering which may have been occasioned to a party by the publication of the slanderous words, and to allow damages therefor"); *Hacker v. Heiney,* 111 Wis. 313, 87 N.W. 249, 251 (1901) (rejecting contention that "no recovery can be had for injury to feelings" in action for slander); *McCarty v. Kinsey,* 154 Ind. 447, 57 N.E. 108, 108 (1900) (holding it was "proper for the jury to consider" slanderous words used in course of an assault and battery "with all the circumstances in evidence, and the humiliation, degradation, shame, and loss of honor, and mental anguish, if any, caused thereby, in determining the amount of damages"); *Gray v. Times Newspaper Co.,* 78 Minn. 323, 324, 81 N.W. 7, 7 (1899) (plaintiff "was entitled to some damages for injury to his feelings, shame, and loss of the good opinion of his fellows, and injury to his standing in the community"); *Louisville Press Co. v. Tennelly,* 105 Ky. 365, 49 S.W. 15, 17 (1899) ("the rule is well settled that the publication of a libel exposes the publisher, not only to compensatory damages for the loss of business, but also to a judgment for the mental suffering that the libel or slander inflicts upon the plaintiff"); *Cole v. Atlanta & W.P.R. Co.,* 102 Ga. 474, 31 S.E. 107, 108 (1897) (permitting action by plaintiff passenger against railroad for its employee's slander, which caused plaintiff "to undergo the pain and mortification of being publicly denounced"); *Fry v. McCord,* 95 Tenn. 678, 33 S.W. 568, 571 (1895) (damages for slander per se may include "pain, mental anxiety, or general loss of reputation"); *Taylor v. Hearst,* 70 Cal. 262, 270, 40 P. 392, 393-94 (1895) ("actual damages embraces recovery for loss of reputation, shame, mortification, injury to feelings, etc.; and while special damages must be alleged and proven, general damages for outrage to feelings and loss of reputation need not be alleged in detail"); *Taylor v. Dominick,* 36 S.C. 368, 15 S.E. 591, 593-94 (1892) ("the elements of damages in the action for malicious prosecution are the injury to the reputation or character, feelings, health, mind, and person, as well as expenses incurred in defending the prosecution"); *Stallings v. Whittaker,* 55 Ark. 494, 18 S.W. 829, 831 (1892) (damages in slander action

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very sort of injury Murphy suffered – and at least five more states allowed an action for alienation of affections, also a nonphysical injury.* As a result, we see

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may compensate for "mental suffering and mortification"); *Republican Pub. Co. v. Mosman,* 15 Colo. 399, 410, 24 P. 1051, 1055 (1890) ("in cases of written slander where the defamatory matter is libelous *per se,* the mental suffering of the plaintiff, occasioned by the false publication, may be taken into consideration, in awarding general compensatory damages"); *Commercial Gazette Co. v. Grooms,* 10 Ohio Dec. Reprint 489, 1889 WL 346, at *4 (1889) ("The most natural result from an injury to reputation is mental suffering and it is a proper element to be considered in estimating damages in a libel suit"); *Boldt v. Budwig,* 19 Neb. 739, 28 N.W. 280, 283 (1886) ("jury should consider the damage to her character, as well as her mental suffering caused [by the slander]"); *Riddle v. McGinnis,* 22 W.Va. 253, 1883 WL 3242, at *15 (1883) ("in . . . actions for wilful and wanton injuries done to the person and reputation . . . the plaintiff is entitled to recover damages . . . for his mental anguish"); *Swift v. Dickerman,* 31 Conn. 285, 1863 WL 763, at *7 (1863) (holding "anxiety and suffering [due to slander] were proper subjects for compensation to the plaintiff, and ought to be atoned for by the defendant"); *Beehler v. Steever,* 1 Miles 146, 1837 WL 3209, at *6 (1837) (noting in syllabus that "[o]utrage to the plaintiff's feelings and peace of mind may be considered" by the jury in awarding damages for slander).

* *See, e.g., Greuneich v. Greuneich,* 23 N.D. 368, 137 N.W. 415 (N.D. 1912); *Hillers v. Taylor,* 116 Md. 165, 81 A. 286 (Md. 1911); *Seed v. Jennings,* 47 Or. 464, 83 P. 872 (Or. 1905); *Tucker v. Tucker,* 74 Miss. 93, 19 So. 955 (Miss. 1896); *Samuel v. Marshall,* 30 Va. 567, 1832 WL 1822 (Va. 1832). An action for "alienation of affection" enabled the plaintiff to recover damages for mental suffering and reputational damage arising from the defendant's interference in the relationship between the plaintiff and his or her spouse. *See generally* RESTATEMENT (SECOND) OF TORTS § 683 cmt. f (1977) ("It is unnecessary for recovery that

(Continued on following page)

no meaningful distinction between Murphy's award and the kinds of damages recoverable for personal injury when the Sixteenth Amendment was adopted. Because, as we have seen, the term "incomes," as understood in 1913, clearly did not include damages received in compensation for a physical personal injury, we infer that it likewise did not include damages received for a nonphysical injury and unrelated to lost wages or earning capacity.

The IRS itself reached the same conclusion when it first addressed the question, expressly affirming that personal injuries included nonphysical personal injuries:

> [T]here is no gain, and therefore no income, derived from the receipt of damages for alienation of affections or defamation of personal character. . . . If an individual is possessed of a personal right that is not assignable and not susceptible of any appraisal in relation to market values, and thereafter receives either damages or payment in compromise for an invasion of that right, it can not be held that he thereby derives any gain or profit.

Sol. Op. 132, I-1 C.B. 92, 93 (1922); *see also Hawkins v. Commissioner,* 6 B.T.A. 1023, 1024-25 (U.S. Bd. of Tax App. 1927) (holding "compensation for injury to [plaintiff's] personal reputation for integrity and fair

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the acts of the defendant cause any financial loss to the injured spouse").

dealing" was not income because it was "an attempt to make the plaintiff whole as before the injury"). Note that the Service regarded such compensation not merely as excludable under the IRC, but more fundamentally as not being income at all.

In sum, every indication is that damages received solely in compensation for a personal injury are not income within the meaning of that term in the Sixteenth Amendment. First, as compensation for the loss of a personal attribute, such as well-being or a good reputation, the damages are not received in lieu of income. Second, the framers of the Sixteenth Amendment would not have understood compensation for a personal injury – including a nonphysical injury – to be income. Therefore, we hold § 104(a)(2) unconstitutional insofar as it permits the taxation of an award of damages for mental distress and loss of reputation.

III. Conclusion

Albert Einstein may have been correct that "[t]he hardest thing in the world to understand is the income tax," *The Macmillan Book of Business and Economic Quotations* 195 (Michael Jackman ed., 1984), but it is not hard to understand that not all receipts of money are income. Murphy's compensatory award in particular was not received "in lieu of" something normally taxed as income; nor is it within the meaning of the term "incomes" as used in the Sixteenth Amendment. Therefore, insofar as § 104(a)(2)

permits the taxation of compensation for a personal injury, which compensation is unrelated to lost wages or earnings, that provision is unconstitutional. Accordingly, we remand this case to the district court to enter an order and judgment instructing the Government to refund the taxes Murphy paid on her award plus applicable interest.

So ordered.

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 05-5139 **September Term, 2006**

03cv02414

Filed On: December 22, 2006

[1012659]

Marrita Murphy and Daniel J. Leveille,
Appellants

v.

Internal Revenue Service and
United States of America,
Appellees

BEFORE: Ginsburg, Chief Judge, and Rogers and Brown, Circuit Judges

ORDER

It is **ORDERED**, on the court's own motion, that this case be scheduled for oral argument before the above-named panel at 9:30 a.m. on Monday, April 23, 2007. It is

FURTHER ORDERED that the judgment filed August 22, 2006, be vacated. It is

FURTHER ORDERED, on the court's own motion, that the following briefing schedule apply in this case:

Brief and Appendix for Appellant	January 22, 2007
Brief for Amicus for Appellant	January 22, 2007
Brief for Appellee	February 21, 2007
Reply Brief for Appellant	March 7, 2007

Appellant must raise all issues and arguments in the opening brief. The court ordinarily will not consider issues and arguments raised for the first time in the reply brief.

Parties are strongly encouraged to hand deliver their briefs to the Clerk's office on the date due. Filing by mail could delay the processing of the brief. Additionally, parties are reminded that if filing by mail, they must use a class of mail that is at least as expeditious as first-class mail. *See* Fed. R. App. P. 25(a). All briefs and appendices must contain the date that the case is scheduled for oral argument at the top of the cover. *See* D.C. Cir. Rule 28(a)(8). Because the briefing schedule is keyed to oral argument, the court will grant requests for extensions of time limits for briefs only for extraordinarily compelling reasons.

FOR THE COURT:
Mark J. Langer, Clerk

BY:

Cheri Carter
Deputy Clerk

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 05-5139 **September Term, 2006**

03cv02414

Filed On: December 22, 2006

[1012876]

Marrita Murphy and Daniel J. Leveille,
Appellants

v.

Internal Revenue Service and
United States of America,
Appellees

BEFORE: Ginsburg, Chief Judge, and Sentelle, Henderson, Randolph*, Rogers, Tatel, Garland, Brown, Griffith, and Kavanaugh, Circuit Judges

ORDER

Upon consideration of appellees' petition for rehearing en banc and the response thereto; and the order setting this matter for panel rehearing, it is

ORDERED that the petition be dismissed as moot. A new period for petitioning for en banc review

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* Circuit Judge Randolph did not participate in this matter.

will begin to run following the entry of a new panel judgment.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

BY:

Nancy G. Dunn
Deputy Clerk

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

MARRITA MURPHY, *et al.*	)	
Plaintiffs,	)	
v.	)	**Civil Action No. 03-02414 (RCL)**
INTERNAL REVENUE SERVICE, *et al.*	)	
Defendants.	)	

MEMORANDUM OPINION

This matter comes before the Court on the defendants' motion to dismiss for lack of jurisdiction over the Internal Revenue Service (IRS) as a proper party to this suit, as well as defendants' motion for summary judgment and plaintiff's cross motion for partial summary judgment. FED. R. CIV. P. 12(b)(2), FED. R. CIV. P. 56(c). The defendants move to dismiss because Congress has not explicitly authorized the IRS as an agency to be sued *eo nomine*. *Blackmar v. Guerre,* 342 U.S. 512, 515 (1952). The issue before the court regarding the summary judgment and partial summary judgment motions dispute is whether or not plaintiff's damages were received "on account of physical injuries or physical sickness" under the 1996 amended definition of Internal Revenue Code § 104(a)(2). Further, the parties dispute whether § 104(a)(2) is constitutional under the Fifth Amendment and Sixteenth Amendment. The defendants submitted a motion and memorandum in support of

their position. Plaintiff submitted a memorandum in opposition to the defendants' motion and supporting a cross motion. Defendants subsequently filed a motion in opposition to plaintiff's motion for summary judgment, and plaintiff accordingly provided a reply memorandum. Upon consideration of the parties' filings, the applicable law, the Federal Rules of Civil Procedure and the facts of this case, the Court finds that the defendants' motion to dismiss will be DENIED. Defendant's motion for summary judgment will be GRANTED and plaintiff's cross motion for partial summary judgment will be DENIED.

I. BACKGROUND

Plaintiffs Marrita Murphy and Daniel Leveille filed complaints against the New York National Guard, alleging that their former employer discriminated against them by engaging in conduct that violated six whistle blower environmental statutes. (*Leveille et al. v. New York Air National Guard,* 1995 WL 848112, *3 (DOL Off, Adm. App.)).[1] Each of the whistle blower statutes provide for "compensatory damages." *The Toxic Substances Control Act,* 15 U.S.C. §2622 (1994); *The Safe Drinking Water Act,* 42 U.S.C. §300j-9(I) (1994); *The Clean Air Act,* 42 U.S.C. §7622 (1994); *The Solid Waste Disposal Act,* 42 U.S.C. §6971 (1994); *The Clean Water Act,* 33 U.S.C. §1367

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[1] Marrita Murphy is also known as Marrita Leveille in portions of this litigation.

(1994); *The Comprehensive Environmental Response, Compensation and Liability Act,* 42 U.S.C. §9610 (1994).

During the trial, Dr. Edwin N. Carter and Dr. Barry L. Kurzer testified that plaintiff's injuries were the result of NYANG's conduct. Dr. Carter testified that Murphy sustained "somatic" and "emotional" injuries, including a condition known as "bruxism," or teeth grinding. (Aff. Dr. Carter.) Murphy had no previous history of bruxism, but was initially treated for the condition in March 1994, when Dr. Kurzer immediately recommended a bite guard. (Aff. of Dr. Kurzer, ¶5-6.) Murphy continues to experience pain and tooth damage from the bruxism. (*Id.* at ¶ 13-15.) Additionally, the Administrative Law Judge noted and the Administrative Review Board confirmed that Murphy suffered from other "physical manifestations of stress" including "anxiety attacks, shortness of breath, and dizziness." (*Leveille v. New York Air National Guard,* Recommended Decision and Order at 6 (ALJ Feb. 9, 1998.))

The Secretary of Labor ruled in favor of Murphy on December 11, 1995, and dismissed Daniel Leveille's complaint due to untimely filing. (*Id.*) Shortly thereafter, in 1996, Congress amended 26 U.S.C. § 104(a)(2), the statute governing plaintiff's potential exclusion from taxation, limiting the exclusion to compensatory damages received on account of "physical injuries and physical sickness." Prior to 1996, § 104(a)(2) required only personal injury or sickness to qualify for the tax exemption. On October

25, 1999, Murphy was awarded $70,000 in damages – $45,000 for mental pain and anguish, and $25,000 for damage to her professional reputation. (1999 WL 966951, *5 (DOL Adm. Rev.Bd.)) The Department of Labor Decision and Order on Damages stated that "[b]y authorizing the award of compensatory damages, the environmental statutes have created a 'species of tort liability' in favor of persons who are the objects of unlawful discrimination." (Decision and Order on Damages, p. 4 (Oct. 25, 1999).)

Murphy then filed her 2000 tax return on April 11, 2001, reporting the $70,000 she received in compensatory damages. (Compl. ¶ 6,7.) Plaintiff later sought a refund of the compensatory damages plus interest on April 15, 2001, December 25, 2001, and October 8, 2002, asserting that such damages were exempted from taxation under 26 U.S.C. § 104(a)(2). (Compl. ¶ 8, 9, 10, 20.) The IRS denied plaintiff's claim for a refund, stating that plaintiff did not demonstrate that the compensatory damages were attributable to physical injury or physical sickness. (*Id.* at ¶ 14.) Plaintiff requested an appeal of this decision on January 16, 2003, and when the Appeals Office did not respond within 180 days, plaintiff filed this action on November 21, 2003. (Compl. at 1, 15-17.)

II. ANALYSIS

A. Motion to Dismiss

1. The IRS is a proper party to this suit under the Administrative Procedure Act.

5 U.S.C. § 702(a) (2000) states that "[a] person suffering a legal wrong because of agency action, or adversely affected or aggrieved by agency action . . . is entitled to judicial review," so long as the relief sought is other than monetary damages. More specifically, "[t]he district courts have original jurisdiction of "[a]ny civil action against the United States for the recovery of an internal-revenue tax alleged to have been erroneously or illegally assessed or collected, or any penalty claimed to have been collected without authority or any sum alleged to have been excessive or in any manner wrongfully collected under the internal revenue laws." 28 U.S.C. § 1346 (1997); *United States v. Williams,* 514 U.S. 527, 532 (1995).

Jurisdiction over the United States in federal taxation cases was extended to administrative agencies in 1973. 5 U.S.C. § 703 (1973). The revised statute states that an "action for judicial review may be brought against the United States, *the agency by its official title,* or the appropriate officer" and that such action "is subject to judicial review in civil . . . proceedings for judicial enforcement." *Id.* (emphasis added). 5 U.S.C. § 703 changed the state of the law under *Blackmar v. Guerre,* 342 U.S. 512, 515 (1952), which held that administrative agencies could not sue

or be sued unless Congress authorized the particularly agency as a potential party to the suit. *See Baumohl v. Columbia Jewelry Co.,* 127 F.Supp. 865 (D. Md. 1955); *O'Connell v. IRS,* 93 A.F.T.R.2d (RIA) 1841; *M&M Transp. Co. v. U.S. Industries, Inc.,* 416 F.Supp. 865 (1976).

Current case law supports the § 703 change. In *Sarit v. Drug Enforcement Admin.,* 759 F.Supp. 63, 69 (D.R.I. 1991) defendants' claimed that the Drug Enforcement Administration could not be sued *eo nomine* because it was a federal agency. The court disagreed, explaining that "[t]his . . . is not the case when jurisdiction is viewed in light of the Administrative Procedure Act." The *Sarit* court also referenced the amended language of § 703, noting that "the previous law under *Blackmar v. Guerre* . . . was that suit could not be maintained against an agency. The amendment gets rid of *Blackmar.*" *Id.* (citations omitted). Similarly, in *Blassingame v. Secretary of Navy,* 811 F.2d 65 (2d. Cir. 1987), the court clarified that "[t]he rule that a federal agency cannot itself be sued . . . no longer holds." *See also B.K. Instrument Inc. v. United States,* 715 F.2d 713, 724-25 (2d. Cir. 1983).

In this case, the IRS is a proper party to the suit. Under 5 U.S.C. § 702(a), if a party suffers a legal wrong by an agency action, such a party is entitled to bring her case before this Court as long as she seeks relief other than monetary damages. Plaintiff claims violations of her rights Fifth and Sixteenth Amendment rights, and seeks injunctive and declaratory

relief, thus satisfying 5 U.S.C. § 702(a). Further, this court has jurisdiction over plaintiff's action because it involves a claim of an illegally collected federal tax revenue. 28 U.S.C. § 1346 (1997). Finally, plaintiff properly named the IRS as party to under 5 U.S.C. § 703 (1973), which codified the principle that such a suit may be brought against a government agency.

2. Plaintiff exhausted all remedies prior to filing suit in District Court.

A party aggrieved by an administrative agency action must exhaust available administrative remedies before seeking judicial relief. *Myers v. Bethlehem Shipbuilding Corp.,* 303 U.S. 41, 50-51 (1938); *McKart v. United States,* 395 U.S. 185, 193 (1969); *Department of Transportation. v. Public Citizen,* 541 U.S. 752 (2004). The rationale behind such a requirement is that "[t]he exhaustion doctrine guarantees administrative autonomy and efficiency, and ensures that administrative agencies are afforded an opportunity to address their own error without judicial intervention." *Sharps v. United States Forest Service.,* 28 F.3d 851, 854 (8th Cir. 1994).

Several specific requirements exist for a tax dispute case. First, the litigant must "pay first and litigate later." *Flora v. United States,* 362 U.S. 145, 164 (1960). Furthermore, all civil actions for a refund are governed by 26 U.S.C. § 7422(a), which requires that any suit involving an "erroneously or illegally assessed or collected" internal revenue tax may not be

"maintained in any court" until a claim for a refund or credit is filed with the Secretary.

In this case, plaintiff complied with all applicable requirements for exhaustion of remedies. First, plaintiff paid her taxes up front, in accordance with the "pay first and litigate later" requirement. *Flora v. United States,* 362 U.S. 145, 164. Second, plaintiff filed three amended tax returns on April 15, 2001, December 25, 2001, and October 8, 2002, respectively, and an appeal on December 18, 2002. When plaintiff did not receive a response to her administrative appeal after 180 days, she filed this action on November, 21, 2003. Therefore, plaintiff followed proper procedures in first paying her taxes and then disputing the IRS' assessment of her gross income, and made multiple claims within the IRS prior to filing suit with this Court. Accordingly, plaintiff effectively exhausted all other remedies and her case is properly before this Court.

B. Summary Judgment

1. Standard of Review

Summary judgment is appropriate when "there is no genuine issue as to any material fact." Fed. R. Civ.P. 56(c); *See Celotex Corp. v. Catrett,* 477 U.S. 317, 322-23 (1986). A fact is material if it will affect the outcome of the case. *Id.* Moreover, a moving party is entitled to summary judgment as a matter of law when the law supports the moving party's position. *See Jeffery v. Sarasota White Sox, Inc.,* 64 F.3d 590,

594 (11th Cir. 1995). Inferences drawn from the facts must be viewed in the light most favorable to the party opposing the motion. *Adickes v. S.H. Kress & Co.*, 398 U.S. 144, 157 (1970).

Once the moving party files a proper summary judgment motion, the burden shifts to the non-moving party to produce "specific facts showing that there is a genuine issue for trial." Fed. R. Civ. P. 56(e). The non-moving party cannot establish a genuine issue of material fact exists through "conclusory allegations" or "unsubstantiated assertions." *Little v. Liquid Air Corp.*, 37 F.3d 1069, 1075 (5th Cir. 1994). Any factual assertions contained in the declaration in support of a motion will be accepted by the Court as true unless plaintiff submits his own declarations or other documentary evidence contradicting the assertions in the attached declarations. *See Neal v. Kelly*, 963 F.2d 453, 456 (D.C. Cir. 1992).

2. Plaintiff's damages are income, and are taxable unless exempted by § 104(a)(2) of the Internal Revenue Code.

The Sixteenth Amendment established that "[t]he Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. AMEND XVI. "Gross income" is broadly defined, for purpose of federal income taxation, as "all income

from whatever source derived." 26 U.S.C. §61(a); *Commissioner v. Banks,* 543 U.S. ___ (2005); *Glenshaw Glass Co.,* 348 U.S. 426, 429 (1955); *Helvering v. Clifford,* 309 U.S. 331, 334 (1940). The Supreme Court defined income in *Eisner v. Macomber,* 252 U.S. 189, 207 (1920) as "the gain derived from capital, from labor, or from both combined." While this definition is widely quoted, it was not intended to provide a "touchstone to all future gross income questions." *Glenshaw Glass,* 348 U.S. 426, 431 (1955); *Roemer v. Commissioner,* 716 F.2d 693, 696 n.2 (9th Cir. 1983); *Prescott v. Commissioner,* 561 F.2d 1287, 1293 (8th Cir. 1977). Furthermore, in interpreting the definition of income, courts follow the "default rule of statutory interpretation that exclusions from income must be narrowly construed." *United States v. Burke,* 504 U.S. 244, 248 (1992) (Scalia, J., concurring in judgment, Souter, J., concurring in judgment); see *United States v. Centennial Savings Bank FSB,* 499 U.S. 573, 683-84 (1991); *Commissioner v. Jacobson,* 336 U.S. 28, 49 (1949).

Congress codified one such income tax exception through 26 U.S.C. § 104(a)(2). Prior to 1996, the statute provided that gross income does not include "the amount of any damages (other than punitive damages) received . . . on account of *personal* injury or sickness".[2] *Id.* (emphasis added.) Therefore, prior

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[2] § 104(a)(2) originates from The Revenue Act of 1918, ch. 18, 40 Stat. 1057, § 213(b)(6). The original rationale for the rule was that damages for personal injuries could not be considered a

(Continued on following page)

to the 1996 amendment, "[t]he reference to personal injury did not include purely economic injuries but did embrace 'nonphysical injuries to the individual, such as those affecting emotion, reputation, or character.'" *Polone v. Commissioner,* 2003 WL 22953162, T.C.M. (RIA) 2003-339 (T.C. 2003) (quoting *Burke,* 504 U.S. at 235 n.6.). As amended in 1996, the statute altered the exemption requirements to compensatory damages "on account of *physical injuries or physical sickness.*" (*Id.* (emphasis added).)

The House Report provides further detail regarding the change in language. The report clarifies the meaning of "physical" by explaining that "[i]f an action has its origin in a physical injury or physical sickness, then all damages . . . that flow therefrom are treated as payments received on account of physical injury or physical sickness. . . ." 104 H. Rpt. 737. The report further explains that "emotional distress is not considered a physical injury or physical sickness," and furthermore, any damages based on "employment discrimination or injury to reputation accompanied by a claim of emotional distress" do not fall under the § 104(a)(2) exception. *Id.* The report also notes that "the exclusion from gross income applies to any damages received based on a claim of emotional distress that is attributable to a physical injury or physical sickness." *Id.*

"gain," and therefore, were not considered income. *See* H.R. Rep. No.767 65th Cong., 2d Sess. 9-10 (1918) (1939-1 C.B. (pt. 2) 86, 92).

To determine whether § 104(a)(2) applies, a taxpayer must satisfy the two prong test established in *Commissioner v. Schleier,* 515 U.S. 323, 336-37 (1995). The first prong requires a taxpayer to establish that damages were received through a tort or tort-like action. *Id.* at 335; *Burke,* 504 U.S. at 237. The second prong requires a taxpayer to establish that the damages received were "on account of" a personal injury. *Schleier,* 515 U.S. at 336. However, the 1996 revision to § 104(a)(2) adds the additional requirement that such injuries be *physical* in nature.

Plaintiff's compensatory damages satisfy the first prong of the *Schleier* test. A tort-like cause of action includes "the traditional harms associated with personal injury, such as pain and suffering, emotional distress, harm to reputation, or other consequential damages." *Burke,* 504 U.S. at 239. Moreover, the six environmental statutes from which plaintiff's claim arose provide for "compensatory damages." *The Toxic Substances Control Act,* 15 U.S.C. § 2622 (1994); *The Safe Drinking Water Act,* 42 U.S.C. § 300j-9(I) (1994); *The Clean Air Act,* 42 U.S.C. § 7622 (1994); *The Solid Waste Disposal Act,* 42 U.S.C. § 6971 (1994); *The Clean Water Act,* 33 U.S.C. § 1367 (1994); *The Comprehensive Environmental Response, Compensation and Liability Act,* 42 U.S.C. § 9610 (1994). Finally, the DOL Decision and Order on Damages stated that "[b]y authorizing the award of compensatory damages, the environmental statutes have created a 'species of tort liability' in favor of persons who are the objects of unlawful discrimination." (Decision and

Order on Damages, p. 4 (Oct. 25, 1999).) In this case, plaintiff received compensatory damages for emotional distress and damage to reputation, fitting squarely within the definition of a tort or tort-like action. DOL reaffirmed this finding through specifically stating that the damages awarded were tort-like during the award of plaintiff's damages. Therefore, the first prong of the *Schleier* test is satisfied.

However, the facts of this case do not satisfy the second prong of *Schleier.* First, plaintiff received $25,000 for damage to her professional reputation. (1999 WL 966951, *5 (DOL Adm. Rev.Bd.)) The House Report for the 1996 version of § 104(a)(2) explicitly stated that damages based on "employment discrimination or injury to reputation accompanied by a claim of emotional distress" do not fall within the protection of the tax exemption. 104 H. Rpt. 737. Because plaintiff's $25,000 of compensatory damages was based on damage to Murphy's professional reputation, this award is not specifically exempted by statute, and thus falls within the broader definition of taxable income. *Glenshaw Glass,* 348 U.S. at 431 (noting that the definition of income may include "accessions to wealth.")

Second, plaintiff received $45,000 in damages awarded for mental pain and anguish. Pertaining to emotional distress, the House Report states that "emotional distress is not considered a physical injury or physical sickness," but that "the exclusion from gross income applies to any damages received based on a claim of emotional distress that is attributable to

a physical injury or physical sickness." 104 H. Rpt. 737. (emphasis added). Here, Murphy's mental anguish manifested into a physical problem, bruxism, but this was only a symptom of her emotional distress, not the source of her claim. Plaintiff's emotional distress is not "attributable to her physical injury"; in fact, it is the other way around. Because the statute clearly provides damages must be received "on account of personal physical injury or physical sickness," and because mental pain and anguish and damage to reputation are not physical injuries, plaintiff's emotional distress damages are not included within the statutory exemption under § 104(a)(2). Therefore plaintiff's entire compensatory damages award of $70,000 is lawfully taxed under § 104(a)(2).

3. The revised version of § 104(a)(2) was not applied retroactively.

Plaintiff asserts that § 104(a)(2) was applied retroactively to the compensatory damages, thus violating plaintiff's due process rights under the Fifth Amendment and conflicting with the presumption that legislation is not retroactive unless Congress expresses clear intent. (P. Cross Motion for Partial Sum. Judgment at 32.) Defendants assert that the statute plainly applies to income received after the effective date and, therefore, § 104(a)(2) is not retroactively applied.

The evidentiary record of plaintiff's case was closed in 1994. In 1995, the Secretary of Labor ruled in favor of plaintiff's discrimination complaint. In 1996, Congress amended § 104(a)(2) requiring physical injury or physical sickness for the exception to apply. The prior version of § 104(a)(2) required only personal injury or sickness. However, the plaintiff was awarded compensatory damages in 1999 after the 1996 version of § 104(a)(2) took effect. Therefore, because the plaintiff's damages award took place after the amendment, the 1996 version of § 104(a)(2) was properly applied in this instance.

While the Fifth Circuit applied § 104(a)(2) retroactively in *Hamilton v. United States,* 87 F.3d 682 (5th Cir. 1996), the Court did so because the settlement took place prior to the revision in the tax code. Here, the award was not made until 1999, three years after the tax code revision. Therefore, as the facts of this case maintain a different timeline than the facts of *Dotson,* the 1996 version of § 104(a)(2) was properly applied to plaintiff's award that was assessed and received several years after the statute's amendment.

4. § 104(a)(2) remains constitutional after the 1996 amendments.

a. Fifth Amendment due process clause and takings clause

"In general, a Federal tax law is not violative of the Due Process Clause of the Fifth Amendment of

the U.S. Constitution unless the statute classifies taxpayers in a manner that is arbitrary and capricious." *Hamilton v. Commissioner,* 63 T.C. 601, 606 (1975). Furthermore, courts may only intervene under a due process claim if "the act complained of was so arbitrary as to constrain to the conclusion that it was not the exertion of taxation but a confiscation of property, that is, a taking of the same in violation of the Fifth Amendment, or what is equivalent thereto, was so wanting in basis for classification as to produce such a gross and patent inequality as to inevitably lead to the same conclusion." *Brushaber v. Union Pac. RR,* 240 U.S. 1, 24-25 (1916). Historically, the courts "never used the [substantive] due process clause to regulate federal income tax," and have showed similar restraint under procedural due process claims except for cases involving "specific classifications" or inadequate administrative processes. Bittker & Lokken, Federal Taxation of Income, Estates and Gifts, Volume 1, Third Edition (1999) (citing *Black v. United States,* 534 F.2d 524 (2d Cir. 1976); *McGlotten v. Connally,* 338 F. Supp. 448 (D.D.C. 1972)).

The facts of this case do not provide a strong basis for a due process challenge under the Fifth Amendment. Members of Congress did not arbitrarily nor capriciously alter the applicability of § 104(a)(2) through the 1996 amendment. Moreover, in a similar challenge of the constitutionality of § 104(a)(2), The Court of Appeals for the Sixth Circuit found the revised statute constitutional. The Court noted that

because the statute does not preserve a fundamental right, "the distinction that it creates is constitutional as long as it bears a rational relationship to a legitimate government purpose." *Young v. United States,* 332 F.3d 893, 895-96 (6th Cir. 2003) (citing *Regan v. Taxation with Representation of Washington,* 461 U.S. 540, 547 (1983)). Further, the legislature "is not bound to tax every member of a class or none. It may make distinctions of degree having a rational basis, and when subjected to judicial scrutiny they must be presumed to rest on that basis if there is any conceivable state of facts which would support it." *Carmichael v. Southern Coal & Coke Co.,* 301 U.S. 495, 509 (1937).

In this case, as in *Young,* the legislative history of § 104(a)(2) provides that Congress intended to clarify the state of the law, as well as decrease litigation for cases that do not involve physical injury or physical sickness. H.R. Conf. Rep. No. 104-737, at 300, *reprinted in* 1996 U.S.C.C.A.N. 1677; H.R. Rep. No. 104-586, at 142-43. Clarifying the tax code and decreasing litigation satisfy the minimal requirement of a "rational basis," and therefore § 104(a)(2) does not violate the due process clause under the Fifth Amendment.

Plaintiff's argument that the disputed taxation violates the Takings Clause is also without merit. Courts generally reject the argument that taxing provisions can be classified as "taking of property without due process of law." *See Freeman,* 2001 WL 1140022, T.C.M. (RIA) 2001-254 (Tax Ct. 2001); *see*

also Coleman v. Commissioner, 791 F.2d 68, 70 (7th Cir. 1986); *Van Sant,* 98 A.F.T.R.2d 2002-302, *7 (D.D.C. 2001). The Seventh Circuit clarifies the meaning of taking in *Coleman,* stating that taxation does indeed "take" income, "but this is not the sense in which the constitution uses 'takings.'" *Id.* The Second Circuit further explained that because Article I, section 8, clause 1 of the U.S. Constitution granted Congress the power to tax before the passage of the Sixteenth Amendment, its passage "did no more than remove the apportionment requirement of Article I, §2, cl. 3, from taxes on 'incomes, from whatever source derived.'" Therefore, although taxation on damages that are not exempted under the revised version of § 104(a)(2) may appear to be a "taking" by the government, the constitutional provision was not intended, nor should it be extended, to cover plaintiff's situation in this case.

b. Sixteenth Amendment

Article I, § 8 of the U.S. Constitution delegates to Congress the power "to lay and collect Taxes, Duties, Imposts and Excises, to pay the Debts and provide for the common Defence and general Welfare of the United States; but all Duties, Imposts and Excises shall be uniform through the United States." Article I, § 9 implements a proportionality requirement, stating that "[n]o Capitation, or other direct, Tax shall be laid, unless in Proportion to the Census or Enumeration herein before directed to be taken." U.S. CONST. art. I, § 9. This apportionment requirement

led the Supreme Court to hold the 1894 income tax law unconstitutional in *Pollock v. Farmers' Loan & Trust Co.,* 158 U.S. 601 (1895), which later prompted the passage of the Sixteenth Amendment. Under the Sixteenth Amendment "[t]he Congress shall have power to lay and collect taxes on incomes, from whatever source derived, without apportionment among the several States, and without regard to any census or enumeration." U.S. CONST. amend. XVI. The Sixteenth amendment therefore effectively eliminated the apportionment requirement for income tax.

Plaintiff asserts that the 1996 amendments to § 104(a)(2) are unconstitutional because the statute (a) imposes a direct tax on personal injuries which cannot be classified as income, (b) taxes compensation despite the "in lieu of what?" test, and (c) conflicts with the constrained definition of income established under the Sixteenth amendment.

As previously discussed, "gross income" is broadly defined by statute as "all income from whatever source derived." 26 U.S.C. §61(a). The Supreme Court has broadened its interpretation from "the gain derived from capital, from labor, or from both combined," as established in 1920 in *Eisner,* to a more all-encompassing standard, including "all economic gains not otherwise exempted." *Eisner,* 252 U.S. at 207; *Commissioner v. Banks,* 543 U.S. ___ (2005). In this case, plaintiff argues that § 104(a)(2) assesses a direct tax on personal property rather than a constitutional tax of income. (P. Cross Motion for Partial Summary Judgment at 31.) Further, plaintiff asserts that these

compensatory damages are not income and therefore they cannot be taxed under the Sixteenth amendment. While confusion remains within in the law regarding the exact definition of a "direct tax," because of the broad definition of "income" purported by the tax code and the courts' subsequent interpretation thereof, plaintiff's argument fails.

Plaintiff also argues that the disputed damages are not taxable under the "in lieu of what" test established in *Raytheon Production Corp. v. Commissioner,* 144 F.2d 110 (1st Cir. 1944), *cert. denied* 323 U.S. 779 (1944). *Raytheon* directs the inquiry, "in lieu of what were the damages awarded?" *Id.* at 113. If what is being taxed can be considered "income," it may be taxed; if it cannot, then it is exempted. While defendants do not directly respond to this theory, courts have applied the *Raytheon* test in cases involving settlement, not in cases where damages are awarded by an administrative body. *See Lindsey v. C.I.R.,* 2004 WL 1052772, U.S. Tax Ct., 2004. Moreover, the revised language of § 104(a)(2) indicates that only physical injuries and physical sickness are exempted from the definition of "income." Therefore, anything falling outside this definition is considered income, and is therefore taxable. *Burke,* 504 U.S. at 248 (noting that it is the "default rule of statutory interpretation that exclusions from income must be narrowly construed").

Finally, plaintiff asserts that Congress cannot act unilaterally to determine its taxing power, but is restrained by the Supreme Court and the constitutional

limitations established under the Sixteenth Amendment. While this is true, the Supreme Court has continually affirmed the broad interpretation of the taxing power and the definition of income. *Banks,* 543 U.S. at 6; *Glenshaw Glass Co.,* 348 U.S. at 429; *Helvering,* 309 U.S. at 334. In clarifying the definition of "personal injury" and eliminating injuries based on emotional distress from the exemption, Congress has limited the scope of its taxation power to damages which are not the result of physical injury or sickness. Congress' attempt to clarify the law and decrease litigation is within the boundaries of its limits under the Sixteenth Amendment. See H.R. Conf. Rep. No. 104-737, at 300, *reprinted in* 1996 U.S.C.C.A.N. 1677; H.R. Rep. No. 104-586, at 142-43. Therefore, § 104(a)(2) does not pose a constitutional problem under the Sixteenth Amendment.

III. CONCLUSION

For the foregoing reasons, the defendants' motion to dismiss will be DENIED. Defendants' motion for summary judgment will be GRANTED. Plaintiff's cross-motion for partial summary judgment will be DENIED.

A corresponding Order will issue this date.

Signed by Royce C. Lamberth, United States District Judge, March 22, 2005.

UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

MARRITA MURPHY, et al.	)	
Plaintiffs,	)	
v.	)	**Civil Action No.**
INTERNAL REVENUE SERVICE, *et al.*	)	**03-02414 (RCL)**
Defendants.	)	

ORDER

In accordance with the Memorandum Opinion issued this date; and upon consideration of the defendants' Motion [9] to Dismiss for lack of jurisdiction, the opposition thereto, the reply brief, the applicable law, and the entire record herein, it is hereby

ORDERED that the defendants' Motion [9] to Dismiss is DENIED.

Furthermore, in accordance with the Memorandum Opinion issued this date; and upon consideration of the plaintiffs' Motion [19] for Partial Summary Judgment, the opposition thereto, the reply brief, the applicable law, and the entire record herein, it is hereby

ORDERED that the plaintiffs' Motion [19] for Partial Summary Judgment is DENIED.

Finally, in accordance with the Memorandum Opinion issued this date; and upon consideration of

the defendants' Motion [10] for Summary Judgment, the opposition thereto, the applicable law, and the entire record therein, it is hereby

ORDERED that the defendants' Motion [10] for Summary Judgment is GRANTED; and it is further ORDERED that the plaintiffs' Complaint is hereby DISMISSED WITH PREJUDICE.

SO ORDERED.

Signed by Royce C. Lamberth, United States District Judge, March 22, 2005.

United States Court of Appeals
FOR THE DISTRICT OF COLUMBIA CIRCUIT

No. 05-5139 **September Term, 2007**
03cv02414
Filed On: September 14, 2007

Marrita Murphy and
Daniel J. Leveille,

Appellants

v.

Internal Revenue Service
and United States of
America,

Appellees

BEFORE: Ginsburg, Chief Judge, and Sentelle, Henderson, Randolph,* Rogers, Tatel, Garland, Brown, Griffith, and Kavanaugh, Circuit Judges

ORDER

Upon consideration of appellant's petition for rehearing en banc, and the absence of a request by any member of the court for a vote, it is

ORDERED that the petition be denied.

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* Circuit Judge Randolph did not participate in this matter.

Per Curiam

FOR THE COURT:
Mark J. Langer, Clerk

BY:

Michael C. McGrail
Deputy Clerk